adjustment proportionately across all categories in the affected price cap basket. Thus, when a reallocation occurs within a price cap basket, only the affected SBIs will be adjusted. When the reallocation affects service categories in more than one basket, however, the affected PCIs and SBIs must be adjusted. The upward or downward adjustment to the PCIs and upper SBIs shall be calculated as the percentage of the revenues being added or subtracted from a basket or category, divided by the total revenues recovered through the basket or category at the time of the adjustment. For example, if ten percent of the revenues are being reallocated from a service category, the category upper SBI will be reduced by ten percent. If that revenue amount is only three percent of the PCI for the basket, the PCI is reduced by three percent.

b. Treatment of Remaining Costs Recovered by the TIC

229. *Residual TIC reduction plan.* After the costs identified above have been reallocated to other access services, some costs will continue to be recovered by the TIC. While it is desirable to eliminate the TIC as soon as possible by shifting the costs recovered by the TIC to facilities-based rates, referring separations questions to a Joint Board is the best means of reaching that ultimate objective, as we noted earlier. Even as we make this referral, we will require incumbent LECs to target to the TIC price cap reductions arising in any price cap basket as a result of the application of the "GDP-PI minus X-factor" formula until the per-minute TIC is eliminated, as many parties have suggested.[293] These parties submit that this targeting will permit incumbent LECs to manage the reduction in revenues recovered by the TIC, while reducing the amount at issue in the TIC. Sprint states that, using a targeting approach, we would not need to address the cost allocation issues raised by Part 36 and Part 69.[294] Targeting these price cap reductions to the TIC reduces the TIC over a reasonable period, thereby ultimately substantially reducing what is widely recognized to be an inefficient aspect of the access rate structure. We require price-cap LECs to begin these targeted X-factor reductions to the TIC in tariff filings to become effective July 1, 1997.

230. Targeting PCI reductions to the per-minute TIC will not change the overall revenue levels that our price cap mechanisms permit incumbent LECs to receive. We have reallocated those costs that the record shows are clearly related to other facilities-based elements. The upcoming separations proceeding may provide additional data that will permit us to reallocate more costs to facilities-based rate elements, or to the intrastate jurisdiction. The approach we take is a reasonable response to the D.C. Circuit's remand directive, and establishes a plan that should substantially reduce the TIC within a reasonable period, pending review of the jurisdictional separations process.

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[293] *See, e.g.,* PacTel Comments at 72; Sprint Comments at 29,52; Ameritech Reply at 32-33; BA/NYNEX Comments at 38.

[294] Sprint Reply at 17-18.

231. We reject ALTS' allegation that targeting the productivity factor to the TIC undercuts the rationale for the "just and reasonable" status of all price-cap rates, which ALTS contends is dependant on the widespread application of the X-factor. The targeting approach that we adopt will eliminate anticompetitive aspects of the TIC, which promotes inefficient entry into the transport market by imposing some transport costs on IXCs that do not cause the costs to be incurred. In addition, by spreading current TIC revenues across all price cap PCIs and SBIs, our targeting method does not offer TIC revenues special insulation against the pressures of the competitive marketplace, as would some proposals to bulk-bill the TIC to IXCs. We also decline to adopt the approach of spreading the remaining costs recovered by the TIC proportionately among all transport services, as proposed by State Consumer Advocates.[295] That approach might, because of the unknown nature of the costs that will remain in the TIC, result in an excessive reallocation to transport.

232. The D.C. Circuit instructed us to revise our transport rate structure rules to be more consistent with cost-causation principles. There is conflicting evidence in the record concerning the nature of the costs contained within the residual TIC; these costs may be traffic sensitive or NTS and may be associated with common line, transport or switching services. BA/NYNEX states, without explanation, that the costs in the TIC are NTS in nature.[296] To the extent that some portion of the residual TIC has its origin in the methods used to separate cable and wire facilities between the regulatory jurisdictions, it seems likely that BA/NYNEX is partially correct in this assertion. The evidence, however, does not clearly resolve this issue.

233. If the costs remaining in the residual TIC are NTS, as BA/NYNEX suggests, then traffic-sensitive recovery could artificially raise per-minute rates for interstate access. These higher per-minute access rates could distort the market for interstate toll services by artificially suppressing demand for interstate toll services and by encouraging users that efficiently could make use of the network to instead seek other alternatives. Conversely, if costs remaining in the residual TIC are usage-sensitive, flat-rating may also create a distortion by encouraging inefficient overuse of interstate toll services. Because the limited evidence in the record suggests that at least some amount of the residual TIC represents NTS costs, and because we wish to see that consumers enjoy the benefits of usage of the network to the greatest extent possible, we find that we should err, if at all, on the side of NTS recovery of these costs. For elements not demonstrably reflecting usage-sensitive costs, therefore, we

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[295] State Consumer Advocates Comments at 34-37.

[296] BA/NYNEX Reply at 39-40. USTA and many incumbent LECs proposed recovering the remaining TIC costs through a bulk billing mechanism based on an IXC's share of presubscribed lines or revenues. *See, e.g.*, USTA Comments at 66; BA/NYNEX Comments at 38; PacTel Comments at 72; SNET Reply at 27-28. This proposal to use presubscribed lines is consistent with treating the remaining costs recovered by the TIC as NTS costs.

find, on balance, compelling policy arguments in favor of flat-rated pricing because usage-sensitive recovery of any NTS costs artificially suppresses demand for interexchange calling by inflating per-minute rates. In the absence of definitive evidence as to the nature of the residual TIC amounts, we conclude that the public interest would be better served by imposing these costs on IXCs on a flat per-line basis, rather than on a per-minute basis.

234. Accordingly, we seek to migrate the current usage-based charges into flat-rated charges as quickly as possible consistent with avoiding short-term market distortions. We do that by: (1) on July 1, 1997, drawing down the per-minute-of-use residual TIC charge by targeting the price cap productivity (X-factor) adjustment to the trunking PCI and, specifically, the TIC SBI, thus effectively spreading those residual TIC revenues, which otherwise would be recovered exclusively on a minute of use basis, among the universe of (both traffic-sensitive and NTS) access services and moving TIC recovery closer to flat-rated recovery; (2) starting in January 1998, recovering remaining residual TIC revenues through PICC charges each year, subject to the PICC cap; and (3) drawing down any remaining residual per-minute TIC revenues each July by targeting the annual X-Factor adjustments to those revenues.

235. The targeting of price cap productivity reductions to the TIC will be accomplished in the following manner. Because the price cap LECs will not have reallocated facilities-based costs contained in the TIC before they file tariffs to be effective July 1, 1997, we first direct the price cap LECs to compute their anticipated "residual" TIC amount by excluding revenues that are expected to be reassigned on a cost-causative basis to facilities-based charges in the future, pursuant to the transition plan described in this Order. To determine TIC amounts so excluded, NYNEX, BellSouth, U S West, and Bell Atlantic shall use the residual TIC percentage estimates contained in USTA's *ex parte* letter filed May 2, 1997, to compute their respective anticipated residual TICs.[297] SBC Communications shall use the cost data for SWBT, Pacific Bell, and Nevada Bell contained in its *ex parte* letter filed April 24, 1997 to estimate its residual TICs.[298] Each remaining price cap LEC shall estimate a "residual" TIC in an amount equal to 55 percent of its current TIC revenues. For these remaining price cap LECs, we find that this 55 percent level represents a reasonable, but conservative estimate. The 55 percent level corresponds approximately to the lowest residual TIC percentage identified in the record, and three of the price cap LECs that submitted data on the record are within a few percentage points of this level. We therefore find that residual

[297] These percentages are as follows: NYNEX, 77.63 percent; BellSouth, 56.93 percent; U S West, 59.14 percent; and Bell Atlantic, 63.96 percent. *See* Letter from Linda Kent, Associate General Counsel, USTA, to William F. Caton, Acting Secretary, filed May 2, 1997.

[298] These percentages, calculated from TIC data supplied, are: SWBT, 69.11 percent; Pacific Bell and Nevada Bell combined, 53.52 percent. *See* Letter from Todd F. Silbergeld, Director -- Federal Regulatory, SBC Communications, Inc., to William F. Caton, Acting Secretary, April 24, 1997.

TIC estimates at the 55 percent level for companies that have not developed actual percentage estimates on the record will be reasonable, but will also minimize the risk that we will eliminate facilities-based TIC costs with targeted X-factor price cap reductions.

236. The "GDP-PI minus X" adjustments LECs ordinarily would apply to each of their price cap indices (i.e. revenues) for the July 1, 1997, annual filing shall be applied by LECs to reduce their calculated anticipated "residual" TIC revenues. For tariffs to become effective July 1, 1997, the price cap LECs shall calculate the annual price cap reduction resulting from the application of the productivity adjustment to each basket other than the interexchange basket, and shall sum the dollar effects of the adjustment. If the effect is to reduce PCIs, the dollar amount shall be targeted completely to the trunking basket PCI and the TIC SBI, without changing the PCIs or SBIs for any other basket or service category. The percentage reduction in the PCI and SBI shall equal the ratio of the total dollar effect of the price cap annual adjustment to the dollar value of the PCI and SBI, respectively. If the effect of the productivity adjustment would increase the PCIs, the PCIs shall be adjusted in their usual fashion, and no targeting to the TIC shall occur. This avoids exacerbating an already inefficient aspect of the access rate structure.

237. Price cap LECs will begin reallocation of facilities-based TIC components on January 1, 1998. At that time, the price cap LECs should all have actual cost data reflecting the facilities-based components of the TIC. If, at that time, any price cap incumbent LEC determines that its use of the applicable residual TIC estimate, above, resulted in more PCI reductions being targeted to the interconnection charge in its tariff filing to become effective on July 1, 1997, than were required to eliminate the per-minute interconnection charge, then that price cap LEC shall make necessary exogenous adjustments to its PCIs and SBIs to reverse the effects of the excess targeting.

238. For tariff filings to become effective July 1, 1998, and annually in July thereafter, all price cap LECs will have actual cost data reflecting the facilities-based components of the TIC and will be able to target reductions to actual anticipated residual per-minute TIC amounts without resort to the percentage estimates prescribed above. For these filings, "GDP-PI minus X" adjustments similar to those described above shall be targeted to the trunking basket PCI and the TIC SBI to reduce residual per-minute TIC amounts recovered through per-minute originating and terminating access charges.

239. To avoid the adverse effects of per-minute pricing of costs that may be NTS, we require price cap LECs to recover residual TIC amounts not otherwise eliminated by targeted X-factor reductions, described above, through the flat-rated PICC to the extent the PICC is below its ceiling. In order to ensure that primary residential and single line business subscribers do not pay more than their fair share of the residual TIC, however, we prohibit price cap LECs from charging a PICC on primary residential or single-line business lines that recovers TIC revenues that exceed residual TIC revenues permitted under our price cap rules

divided by the total number of access lines. As the PICC caps increase each year, more of the residual TIC charge can be included in the flat-rated PICC. Any residual TIC amounts that cannot be recovered through the PICC shall be recovered on a per-minute basis from originating traffic, subject to a cap on per-minute originating access charges, as explained in Section III.A, above.[299] If this cap is exceeded, the residual TIC shall be recovered through per-minute terminating switched access rates. Although a portion of the residual TIC will be recovered through PICC charges, the TIC will remain in the trunking basket. Therefore, to ensure that excess headroom is not created in the trunking basket, price cap LECs shall include the TIC revenues received from the flat-rated PICC in calculating the API for the trunking basket and the SBI for the TIC.

240. The policies adopted when the TIC was created require incumbent LECs to assess the TIC on all minutes that interconnect with the incumbent LEC switched access network, including minutes that transit a CAP's transport network without using any incumbent LEC transport facilities. As we noted in the NPRM,[300] and as some commenters assert,[301] if the incumbent LEC's transport rates are kept artificially low and the difference is recovered through the TIC, competitors of the incumbent LEC pay some of the incumbent LEC's transport costs. In a recent arbitration between Teleport and US West, the Colorado Commission has precluded US West from imposing the TIC on competitors for the portion of transport that U S West does not provide.[302] We find that our current policy, which requires competitive entrants to pay the TIC even in cases where it provides its own transport, is inconsistent with the procompetitive goals of the 1996 Act. We therefore modify our rules to permit incumbent LECs to assess any per-minute residual TIC charge only on minutes that utilize incumbent LEC transport facilities, and not on any switched minutes of CAPs that interconnect with the incumbent LEC switched access network at the end office.

241. *Other Approaches.* We reject alternative methods for recovering the TIC that were proposed in the record. The majority of the incumbent LEC parties supported recovering any remaining costs in the TIC by bulk billing such amounts to IXCs based on

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299 *See* para. 100, above.

300 NPRM at ¶ 97.

301 *See, e.g.*, Teleport Comments at 30-32; Time Warner Comments at 12-13, 15.

302 *See TCG Colorado Petition for Arbitration Pursuant to § 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with U S West*, Docket No. 96A-329T, Decision Regarding Petition for Arbitration, Decision No. C96-1186 (adopted Nov. 5, 1996); *TCG Colorado Petition for Arbitration Pursuant to § 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with U S West*, Docket No. 96A-329T, Order Denying Applications for Rehearing, Reargument, or Reconsideration, Decision No. C96-1344 (adopted Dec. 18, 1996), at ¶ I.B.1.4; Letter from Judith Herrman, Manager, Federal Regulatory Affairs, Teleport Communications Group, to Richard Lerner, Competitive Pricing Division, FCC, April 11, 1997.

each IXC's share of revenues, or presubscribed lines.[303] Other incumbent LECs proposed establishing "public policy" elements to recover the residual TIC.[304] These approaches would insulate TIC costs from the pressures of the competitive market and guarantee incumbent LECs the recovery of these amounts, even where such costs have resulted from inefficiencies that the competitive market -- but not regulators -- detected and otherwise would eliminate. This would be inconsistent with the development of an efficient competitive market. Our resolution of the TIC will allow LECs a reasonable opportunity to recover their costs, without providing a guarantee. We also reject the idea of spreading the remaining costs recovered by the TIC proportionately over all transport services, as suggested by AARP, *et al.* As we noted earlier, some of the remaining costs in the TIC may implicate certain Commission decisions separating costs between the federal and state jurisdictions and thus may be related to services other than transport. We, therefore, believe that awaiting further consideration by a Joint Board is a more practical means of ultimately resolving the TIC issue.

242. Some parties have requested that a portion of the costs recovered by the TIC should be considered to be universal service costs.[305] We do not find this argument persuasive. Elsewhere in this Order, we have reallocated the TIC's identifiable cost components. On the basis of the record before us, we cannot clearly associate the remaining TIC revenues with any particular facilities or services. The parties arguing that these costs are related to universal service have not made any clear showing as to the source of these costs or demonstrated why they believe that these TIC revenues are either costs of universal service that should be recovered from the universal service fund or constituent costs of supported services.

243. We have analyzed the effect of the reallocation of TIC costs and the new recovery procedures on small business entities, including small LECs and new entrants, and find that the changes will facilitate the development of a competitive marketplace by moving incumbent LEC rates toward cost-based levels and by eliminating the ability of incumbent LECs to assess the TIC on switched access minutes that do not use incumbent LEC transport facilities. These pricing revisions may create new opportunities for small entities wishing to enter the telecommunications market.

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[303] *See, e.g.*, USTA Comments at 66; BellSouth Comments at 13-14; PacTel Comments at 72.

[304] *See, e.g.*, U S West Comments at 71-73; SWBT Reply at 11; GTE Comments at 39, 41-44.

[305] *See, e.g.*, WITA Comments at 8; Texas Public Utility Counsel Comments at 21.

E. SS7 Signalling

1. Background

244. SS7 is a network protocol used to transmit signalling information over common channel signalling networks. As described in greater detail in the NPRM, signalling networks like SS7 establish and close transmission paths over which telephone calls are carried.[306] Signalling networks are also used to retrieve information from remote data bases to enable credit card and collect calling. SS7 systems are also used to transmit information needed to provide custom local area signalling services like automatic call back.[307]

245. An SS7 network consists of several primary components -- signalling points, signal transport links, and dedicated lines used for access to an incumbent LEC's signalling network (signal links). Signalling points are nodes in an SS7 network that originate, transmit, or route signalling messages. There are three principal types of signalling points: service switching points (SSPs), service control points (SCPs), and signalling transfer points (STPs). An SSP is a switch that can originate, transmit, and receive messages for call setup and database transactions. An SCP serves as a database that stores and provides information used in the routing of calls, such as the line information database (LIDB) used to validate calling cards or the database that identifies the designated long-distance carrier for toll-free service. An STP is a specialized packet switch that performs screening and security functions and switches SS7 messages within the signalling network.

246. Signal transport links are facilities dedicated to the transport of SS7 messages within the incumbent LEC's signalling network. Finally, dedicated network access lines (DNALs) consist of dedicated circuits that transmit queries between the incumbent LEC's signalling network and the signalling networks of other individual carriers, such as IXCs. A carrier's DNAL is connected to an incumbent LEC's signalling network through a port on an incumbent LEC's STP.

247. Under the interim transport rate structure, incumbent LECs charge IXCs and other access customers a flat-rated charge (dedicated signalling transport) under Part 69 for the use of dedicated facilities used to connect to the incumbent LEC's signalling network. This rate element has two subelements -- a flat-rated signalling link charge for the dedicated network access line (dedicated signalling line) and a flat-rated STP port termination charge.[308] Most other signalling costs, such as costs for switching messages at the STP and transmitting

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[306] NPRM at ¶¶ 123-25.

[307] *See Ameritech SS7 Waiver Order*, 11 FCC Rcd at 3841 (1996).

[308] 47 C.F.R. § 69.125.

messages within the signalling network, are not recovered through facility-based charges and thus most, if not all, of these costs are embedded in the TIC or in the local switching charge and recovered through per-minute-of-use charges. Retrieval of information from databases for toll-free calls and LIDB databases, however, is charged on a per-query basis.[309]

248. In the NPRM, we solicited comment on whether the Commission should revise its rate structure for SS7 services to reflect the SS7 rate structure implemented by Ameritech.[310] In March, 1996, the Commission granted a waiver to Ameritech, allowing it to restructure its recovery of SS7 costs through four unbundled charges.[311] These charges correspond to various functions performed by signalling networks: signal link, STP port termination, signal transport, and signal switching.

249. The Ameritech waiver was granted to allow Ameritech to realign its charges for SS7 services more closely with the manner in which such costs are incurred. Unbundling of SS7 services from transport and local switching ensures that transport and local switching customers do not pay for SS7 services they do not use. Unbundling also enables Ameritech to offer SS7 services to competing providers of local exchange and exchange access services without requiring the purchase of other elements that the competitors do not need.[312] In support of its waiver petition, Ameritech noted that it had received numerous customer requests for such unbundling. It also explained that it had deployed equipment necessary for measuring third-party usage of its SS7 networks, enabling the company to bill its SS7 services separately from its switched access services.[313]

250. The NPRM also requested comment on whether incumbent LECs should be allowed to impose separate charges for ISDN User Part (ISUP) messages and Transaction Capabilities Application Part (TCAP) messages.[314] ISUP messages are used to set up and take down calls. For example, ISUP messages include the initial address message used to establish and close the transmission path used to carry a telephone call.[315] TCAP messages, on the other hand, are used to carry information between SSPs that support particular services, such

[309] 47 C.F.R. § 69.120.

[310] NPRM at ¶ 127.

[311] *Ameritech SS7 Waiver Order*, 11 FCC Rcd 3839 (1996).

[312] 11 FCC Rcd at 3853.

[313] 11 FCC Rcd at 3848.

[314] NPRM at ¶ 135.

[315] 11 FCC Rcd at 3841-42.

as toll free services, LIDB services and certain custom local area signalling services (CLASS) like automatic call back.[316] We noted that differentiation between charges for ISUP and TCAP messages may be economically justified because TCAP messages tend to be shorter in average length and place lower demands on the signalling network that ISUP messages.[317]

251. The NPRM also requested comment regarding the appropriate placement of SS7 signalling elements in price cap baskets. Currently, STP port termination rates and charges for the signalling link, or DNAL, are placed in the trunking basket.[318] Because both services are dedicated to particular SS7 customers, rates for these elements are flat-rated. We requested comment on whether the STP port termination charge should be placed in its own service category in the traffic-sensitive basket. We noted that interconnectors can provide their own signalling link, exposing that service element to some measure of competition. The STP port termination, on the other hand, is relatively insulated from competitive pressures because it is part of the incumbent LEC's STP and must be purchased from the incumbent LEC under existing network architecture.

2. Discussion

252. As we noted in the *Ameritech SS7 Waiver Order*, the removal of SS7 costs from the local switching and transport interconnection charge rate elements would benefit access customers that pay for these services but do not actually use an incumbent LEC's signalling services. It would also benefit alternative local service providers by enabling them to purchase separate SS7 services from incumbent LECs to support their provision of competing local exchange or exchange access services.[319] Unbundling the individual SS7 components into separate charges would further promote efficiency by ensuring that signalling charges more accurately reflect the costs of providing such services. Competitive service providers could limit their signalling costs by purchasing only the signalling elements they need.[320] Despite these benefits, however, we are reluctant to impose on incumbent LECs the cost burden of installing metering or other equipment needed to measure third party usage of

[316] *Id.*

[317] NPRM at ¶ 135.

[318] 47 C.F.R. § 61.42(d)(3); NPRM at ¶¶ 128, 130.

[319] 11 FCC Rcd at 3853.

[320] *Id.*

signalling facilities.[321] In granting Ameritech a waiver to implement its unbundled SS7 rate structure, we noted that Ameritech had previously installed the equipment and other facilities needed to meter independent signalling usage.[322] Although we encourage actions that would promote disaggregation and unbundling of SS7 services, we will not require incumbent LECs to implement such an approach and incur the associated equipment costs of doing so. The record indicates that, as a general matter, the costs of mandating the installation of metering equipment may well exceed the benefits of doing so.[323]

253. Instead, we will permit incumbent LECs to adopt unbundled signalling rate structures at their discretion and acquire the appropriate measuring equipment as needed to implement such a plan. Specifically, incumbent LECs may implement the same unbundled rate structure for SS7 services that we approved in the *Ameritech SS7 Waiver Order*.[324] We recognize, however, that other signalling rate structures may achieve the same benefits that are available under the Ameritech rate structure. Hence, an incumbent LEC may implement an unbundled signalling rate structure that varies from the approach implemented in the *Ameritech SS7 Waiver Order* by filing a petition demonstrating that the establishment of new rate elements implementing such a service is consistent with the public interest.[325] We note, however, that variations in signalling rate structures among incumbent LECs could impose burdens on IXCs if IXCs must adapt to a diverse range of unbundled signalling rate structures.[326] We anticipate that, if incumbent LECs choose to adopt unbundled rate structures for their SS7 network services, they will evaluate how the implementation of these plans will affect their prospective customers.[327]

254. With respect to rate differentiation between ISUP and TCAP messages, the NPRM expressed the concern that imposing rate differentiation may be inconsistent with rate

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[321] Bell Atlantic and NYNEX estimate the cost of installing facilities to measure SS7 usage ranges between $15 million and $40 million. BA/NYNEX Comments at 40. Sprint estimates that the cost would run between $15 million and $20 million. Sprint Comments at 31.

[322] 11 FCC Rcd at 3844-45.

[323] USTA Comments at 37; BA/NYNEX Comments at 40; PacTel Comments at 73; GTE Comments at 53.

[324] A carrier could adopt the Ameritech rate structure pursuant to 47 C.F.R. 69.4(g), which permits a carrier to implement rate structures previously approved by the Commission for other carriers.

[325] 47 C.F.R. § 69.4(g).

[326] *See* Sprint Comments at 31.

[327] Sprint suggests that an industry forum may be appropriate to develop an optimum rate structure for unbundled signalling services. Sprint Comments at 31.

structure simplicity.[328] Several commenters indicate that the costs of implementing rate differentiation would exceed the benefits of such an approach.[329] We further note that commenters offered little, if any, general support for the adoption of rate differentiation. Accordingly, to avoid unnecessary complexity and to avoid the imposition of unnecessary regulatory costs, we will not impose a rate differential between ISUP and TCAP messages.

255. With respect to the placement of SS7 rate elements in price cap baskets, we have previously recognized that the signalling link and the STP port termination are not subject to the same level of competition. As noted in the *Ameritech SS7 Waiver Order*, STP port termination is provided only by incumbents while the signalling link can be provided by SS7 customers themselves or by other alternative providers.[330] Comments filed in this proceeding also acknowledge this competitive disparity.[331] Although Ameritech discounts the risk that STP port termination charges would be used to offset price reductions for the signal link, it nevertheless acknowledges the existence of the competitive differential we suggested in the NPRM. Other commenters argue that the competitive disparity is sufficient to justify concerns that price cap LECs would adjust their rates to account for the competitive differential. Accordingly, we will establish a new STP port termination rate element in the traffic-sensitive basket. Placing these SS7 services in different price cap baskets will ensure consistency with the Commission's general approach of maintaining elements with similar competitive characteristics in the same service baskets.

F. Impact of New Technologies

256. The NPRM requested comment regarding the rate structure treatment of new technologies that enable new telecommunications services and, by enhancing the productivity of telecommunications facilities, lower prices for services in the future. These technologies, which we describe in greater detail in the NPRM, include synchronous optical networks (SONET), Asynchronous Transfer Mode (ATM) switching, and advanced intelligent networks (AIN). We invited commenters to recommend specific rate structure rules that would reflect the manner in which incumbent LECs incur costs when providing services utilizing such new technologies.[332]

257. As a general matter, the Commission is reluctant to adopt detailed rules

[328] NPRM at ¶ 135.

[329] MCI Comments at 89; Time Warner Comments at 17; CompTel Comments at 31-32.

[330] 11 FCC Rcd at 3859. NPRM at ¶ 130.

[331] MCI Comments at 87-88; AT&T Reply at 33-34.

[332] NPRM at ¶ 139.

governing rate structures for recovering the cost of deploying advanced technologies. We note that, in the *Price Cap Third Report and Order*, we adopted rules that permit price cap LECs to petition the Commission for the establishment of one or more switched access rate elements to accommodate new services.[333] Under these rules, petitioners must demonstrate either of the following: 1) that the new rate elements would be in the public interest; or 2) that another LEC has previously obtained approval to establish identical rate elements and that the original petition did not rely upon a competitive showing as part of its public interest justification.[334] Because technological advancements emerge rapidly, the adoption of uniform rate structures corresponding to particular technologies may slow investment in the development of newer technologies or improvements in current technologies. Indeed, as a general matter, incumbent LECs oppose the adoption of uniform rate structures for new technologies, suggesting that strict uniform rules in this regard could inhibit development of such technologies. Accordingly, we will refrain from adopting in this Order specific rate structures with respect to SONET, AIN, or other new technologies. As noted above, however, our rules already accommodate rate element adjustments that may be needed on an ad hoc basis when technological advancements justify such modifications. As particular new technologies become used on a widespread basis, we can always consider whether there is a need for a uniform rate structure at that point.

IV. BASELINE RATE LEVELS

A. Primary Reliance on a Market-Based Approach With A Prescriptive Backdrop and the Adoption of Several Initial Prescriptive Measures

1. Background

258. In the NPRM, we established a goal of encouraging efficient competitors to enter local exchange access markets so that incumbent LECs would face substantial competition for the entire array of interstate access services.[335] As a particular service becomes subject to substantial competition from new providers, we proposed to remove that service from price cap and tariff regulation.[336] We sought comment on two general approaches for a transition to reliance on substantial competition to ensure that interstate access charges are closely related to forward-looking economic costs: a "market-based" approach and a "prescriptive" approach.

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[333] *Price Cap Third Report and Order* at ¶ 309-10.

[334] 47 C.F.R. § 69.4(g).

[335] NPRM at ¶ 140.

[336] NPRM at ¶ 149.

Under a market-based approach, we would permit market forces to operate as competition emerges, allowing an incumbent to change its prices in response to competitive entry. To that end, we proposed a two-phase approach in which incumbent LECs would be permitted certain pricing flexibility upon a showing that meaningful competitive entry is possible within a particular local exchange and exchange access market, followed by a further relaxation of price cap regulation when meaningful actual competition developed within the market.[337] We did not propose, however, to abandon the possibility of using the prescriptive tools at our disposal in the event that competition does not develop in some places.

259. As an alternative to the proposed market-based approach, we also sought comment on a prescriptive approach, under which incumbent LECs would be required to change their prices for some or all exchange access services using specific measures adopted by the Commission to more accurately ensure that access charges are closely related to the economic costs of providing interstate access services.[338] We also invited comment whether the two approaches could be merged in some fashion.[339] We emphasized that our ultimate goal under any approach, whether market-based, prescriptive or combined, is to remove from price cap regulation LEC services that are subject to substantial competition. Instead of price cap regulation, we expect eventually to rely on the operation of competitive local markets to prevent incumbent LECs from exercising market power, and thereby to protect consumers.

260. In this section, we endorse the use of a market-based approach generally. Our market-based approach will retain the protection afforded by price cap regulation, while relaxing particular restrictions on incumbent LEC pricing as competition emerges, thereby permitting the development and operation of competitive markets, which will maximize the efficient allocation of telecommunications services and promote consumer welfare. This section also explains how, if competition fails to emerge over time for certain access services in particular geographic areas, we will ensure that the rates for those services reflect the forward-looking economic costs of providing the services. In the NPRM, we sought comment on a number of specific issues concerning the timing and degrees of pricing flexibility and ultimate deregulation. We recognize that we must attend carefully to this task of granting incumbent LECs increased pricing flexibility commensurate with competitive developments, and we will resolve these issues of timing and degree in detail in a subsequent report and order in this docket, where we can more fully discuss these matters.

261. Elsewhere in this Order, we adopt or propose several measures that work within our current price cap structure to lower baseline access charge rate levels consistent with

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337 NPRM at ¶ 140.

338 NPRM at ¶ 141.

339 NPRM at ¶ 144.

evidence that the revised rate levels better reflect the underlying costs of providing interstate access services. In Section IV.C below, we order an exogenous cost reduction to reflect the completion of the amortization of equal access costs. In Section IV.D, we order reallocation of certain marketing and retail expenses and discuss the reallocation of GSF costs. We issue a further notice on GSF costs in Section VII. In the companion *Price Cap Fourth Report and Order*, which we also adopt today, we modify our current price cap plan by adopting a single productivity offset (X-Factor) of 6.5 percent and eliminating sharing while maintaining the low-end adjustment.

2. Discussion

262. The Commission's objective is the one set forth in the 1996 Act -- "opening all telecommunications markets to competition."[340] Therefore, we must ensure that our own regulations do not unduly interfere with the development and operation of these markets as competition develops. If we successfully reform our access charge rules to promote the operation of competitive markets, interstate access charges will ultimately reflect the forward-looking economic costs of providing interstate access services. This is so, in part, because Congress established in the 1996 Act a cost-based pricing requirement for incumbent LECs' rates for interconnection and unbundled network elements, which are sold by carriers to other carriers. As we have recognized, interstate access services can be replaced with some interconnection services or with functionality offered by unbundled elements.[341] Because these policies will greatly facilitate competitive entry into the provision of all telecommunications services, we expect that interstate access services will ultimately be priced at competitive levels even without direct regulation of those service prices.

263. We decide that adopting a primarily market-based approach to reforming access charges will better serve the public interest than attempting immediately to prescribe new rates for all interstate access services based on the long-run incremental cost or forward-looking economic cost of interstate access services. Competitive markets are superior mechanisms for protecting consumers by ensuring that goods and services are provided to consumers in the most efficient manner possible and at prices that reflect the cost of production. Accordingly, where competition develops, it should be relied upon as much as possible to protect consumers and the public interest. In addition, using a market-based approach should minimize the potential that regulation will create and maintain distortions in the investment decisions of competitors as they enter local telecommunications markets. Finally, under the 1996 Act, implicit universal service subsidies, wherever possible, are to be made explicit and

[340] *Joint Explanatory Statement.*

[341] *E.g.*, NPRM ¶¶ 8-9, 170.

supported by all carriers on an equitable and non-discriminatory basis.[342] To the extent that any implicit subsidies remain in interstate access charges because it was not feasible to identify them or make them explicit, our market-based approach will have the effect of making those implicit subsidies subject to being competed away as competitors offer comparable services at prices that do not include the subsidies. In addition, we note that the rate structure changes we adopt today go a long way towards achieving such ends because the inefficiency produced by distortions in markets "rises as a quadratic function of the relative price distortion."[343] Therefore, the first steps made toward removing distortions caused by our regulations will produce the greatest benefits.

264. The market-based approach to access charge reform that we adopt will not, as some parties assert, expose customers of interstate access services to the unfettered exercise of market power.[344] We will continue to maintain the current mechanisms upon which we rely to ensure that rates for these services are "just and reasonable,"[345] and not unjustly or unreasonably discriminatory.[346] Instead of exposing customers to harm, we expect that permitting incumbent LECs certain kinds of pricing flexibility in response to the development of competition will allow prices for interstate access services to adjust in ways that reflect the underlying economic costs of providing those services without moving outside the range of rates that are just and reasonable. This process of relaxing regulation as competition develops, and ultimately deregulating services subject to effective competition, is well established. For example, many of the types of pricing flexibility discussed in the NPRM are similar to forms of pricing flexibility we have in the past accorded incumbent LECs and IXCs facing increased competition in markets for particular services.[347]

265. Economic teaching also leads to the conclusion that rates for interstate access services will generally move toward the forward-looking economic cost of providing such services in response to increased competition in local exchange and exchange access

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[342] 47 U.S.C. § 254.

[343] Scherer & Ross, *supra.*, at 662.

[344] Appendix B, Section IV.A., *infra.*

[345] 47 U.S.C. § 201.

[346] 47 U.S.C. § 202.

[347] *See, e.g., Expanded Interconnection with Local Telephone Company Facilities*, CC Docket No. 91-141, Report & Order & Notice of Proposed Rulemaking, 7 FCC Rcd 7369 (1992) (geographic deaveraging); *AT&T Communications (Revisions to Tariff FCC No. 12)*, CC Docket No. 87-568, Memorandum Opinion & Order, 4 FCC Rcd 4932 (1989).

markets.[348] In addition, competition will do a better job of determining the true economic cost of providing such services. As competitive entry becomes increasingly possible, IXCs that now purchase interstate switched access services from incumbent LECs will be able to bypass those services where the prices (interstate access charges) do not reflect the economic costs of providing the underlying services. Those IXCs can do this by entering the local markets themselves as local exchange service providers, thereby self-providing interstate access services for their new local exchange service customers. They can also seek out competitive providers of comparable services. As customers choose providers other than incumbent LECs as their local providers, interstate access services will come to be priced competitively. Incumbent LECs will have to respond to competitors' offerings with lower-priced access services of their own in order to retain customers that would otherwise switch to competitors' networks, further increasing the effect of competition on overall access charge payments.

266. The 1996 Act has created an unprecedented opportunity for competition to develop in local telephone markets. It also has provided this Commission with tools for opening markets to competition, and for implementing our market-based relaxation of regulation so that interstate access charges reflect forward-looking economic costs. We recognize, however, that competition is unlikely to develop at the same rate in different locations, and that some services will be subject to increasing competition more rapidly than others.[349] Accordingly, we anticipate that competition will drive rates for some interstate access services toward more economically efficient levels more rapidly in some areas than rates for other services or in other areas. Where competition develops, we will provide incumbent LECs with additional flexibility, culminating in the removal of incumbent LECs' interstate access services from price regulation where they are subject to sufficient competition to ensure that the rates for those services are just and reasonable, and are not unjustly or unreasonably discriminatory.

267. We also recognize, however, that there will be areas and services for which competition may not develop. Therefore, we shall retain many of the existing safeguards afforded by our price cap regulation, including the productivity offset (X-Factor), which

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[348] *See, e.g.,* Dennis W. Carlton & Jeffrey M. Perloff, *Modern Industrial Organization* 92-93 (2d ed. 1994)

[349] The observation that competitive entry will occur in some places, and for some services, more rapidly than others is a corollary to the rule that firms in competitive markets seek to maximize their profits. *See, e.g.,* Carlton & Perloff, *supra*, at 89. To maximize profits, firms naturally seek out those customers and services on which they can generate the most profits. Therefore, some customers are naturally more desirable than others at any given point in time. As competitors attempt to gain the patronage of the customers offering the greatest profit opportunities, they offer lower-priced or more desirable services. These actions have the effect of reducing over time the profitability of serving those particular customers and, as this occurs, the relative profitability of serving other customers or offering other services increases. Therefore, competitors begin seeking to serve these other customers, and entry occurs in new places, or for new services.

requires incumbent LECs to adjust their access charges to reflect changes in the economic cost of providing service. In addition, we also adopt a prescriptive "backstop" to our market-based approach that will serve to ensure that all interstate access customers receive the benefits of more efficient prices, even in those places and for those services where competition does not develop quickly. To implement our backstop to market-based access charge reform, we require each incumbent price cap LEC to file a cost study no later than February 8, 2001, demonstrating the cost of providing those interstate access services that remain subject to price cap regulation because they do not face substantial competition. The Commission will require submission of such studies before that date if competition is not developing sufficiently for our market-based approach to work. Studies should identify and quantify forward-looking costs, short-run and long-run, that are incremental to providing each such service, and also costs that are common as between various services. These studies are required only for non-competitive services; as stated above, we do not intend to regulate prices of services that are subject to substantial competition.

268. We have chosen this date in order to give competition sufficient time to develop substantially in the various markets for interstate exchange access services. We have also chosen this date to permit us and all interested parties to take into account the effects of implementing the substantial changes that we adopt in this Order and that we will be adopting elsewhere to satisfy the universal service goals in section 254. By this date, we also expect to have additional regulatory tools by which to assess the reasonableness of access charges. We may, for example, be able to establish benchmarks based on prices for the interstate access services for which competition has emerged, and use the prices actually charged in competitive markets to set rates for non-competitive services and markets. Carriers could be required either to set their rates in accordance with the benchmarks or to justify their rates using their cost studies.

269. We anticipate that the pro-competitive regime created by the 1996 Act, and implemented in the *Local Competition Order* and numerous state commission decisions, will generate competition over the next few years. Further, it would be imprudent to prejudge the effectiveness of those measures at creating competitive local markets. Rather than ignore or interfere with the effects of this developing competition on prices for interstate access services, we find that the public interest is best served by permitting emerging competition to affect access charge rate levels. In addition, the experience we gain from observing the effects of emerging competition on interstate access services will permit us more effectively and efficiently to implement any prescriptive measures that may be needed in the future to ensure that interstate access services remaining subject to regulation are priced in accordance with the forward-looking economic cost of providing those services.

270. Economic logic holds that giving incumbent LECs increased pricing flexibility will permit them to respond to competitive entry, which will allow prices to move in a way

that they would not have moved were the pricing restrictions maintained.[350] This can lead to better operating markets and produce more efficient outcomes. Deregulation before competition has established itself, however, can expose consumers to the unfettered exercise of monopoly power and, in some cases, even stifle the development of competition, leaving a monopolistic environment that adversely affects the interests of consumers.[351] Therefore, it is important that we design our market-based approach carefully. We must, among other things, decide which, if any, of the rules setting forth specific competitive triggers and corresponding flexibility as proposed in the NPRM we should adopt. We will resolve these issues in the subsequent report and order in this docket.

271. As set forth in the summary of comments appended to this order, AT&T cites to *Farmers Union Central Exchange, Inc. v. FERC*[352] for the proposition that "[r]eliance on competitive forces to constrain exchange access rates, particularly in the presence of strong indications that market forces will not produce the intended results, would be arbitrary and capricious and contravene the Commission's statutory duty to ensure just, reasonable, and nondiscriminatory rates."[353] We disagree with AT&T's assertion. In *Farmers Union*, FERC had stated in its relevant order that ratemaking for oil pipelines should be used solely to prevent price gouging, and had interpreted the Congressional mandate of "just and reasonable" rates as requiring that rates be kept within the zone of commercial reasonableness, not public utility reasonableness.[354] Under this interpretation, FERC had concluded that it would rely primarily on market forces to keep rates reasonable.[355]

272. The court in *Farmers Union* recognized that "[m]oving from heavy to lighthanded regulation . . . can be justified by a showing that . . . the goals and purposes of the statute will be accomplished through substantially less regulatory oversight," but objected to FERC's failure to establish that its new approach would satisfy the "just and reasonable" standard.[356] The court rejected FERC's position that oil pipeline ratemaking should protect

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[350] *E.g.*, Jean-Jaques Laffont & Jean Tirole, *Creating Competition Through Interconnection: Theory and Practice*, 10 J. Reg. Econ. 227-56 (1996).

[351] *See, e.g.*, Jean Tirole, *The Theory of Industrial Organization* 230 (1988).

[352] 734 F.2d 1486, 1508 (D.C. Cir.) (*Farmers Union*), *cert. denied*, *Williams Pipe Line Co. v. Farmers Union Central Exchange, Inc.*, 469 U.S. 1034 (1984).

[353] Appendix B, Sec. IV.A., *infra*.

[354] *Farmers' Union*, 734 F.2d at 1492.

[355] *Id.*

[356] *Id.* at 1510.

only against "egregious exploitation and gross abuse" as being inconsistent with the mandate that Congress had established for FERC.[357] The court concluded that FERC had not shown that market forces were sufficient to rely upon in setting reasonable rates.[358]

273. We reject AT&T's argument that our market-based approach to access charge reform is analogous to FERC's conduct at issue in *Farmer's Union*. Our access charge and price cap rules are designed to ensure that access charges remain within the "zone of reasonableness"[359] defining rates that are "just and reasonable,"[360] and our market-based approach will also be designed to implement this statutory requirement. It will not remove incumbent LECs from regulation immediately, but will implement deregulation in steps, as competitive conditions warrant. Throughout the transition to deregulation in the face of substantial competition, we will maintain many safeguards against unjust or unreasonable rates, such as the price cap indices. We will deregulate incumbent LEC services only when it is reasonable to conclude that competition has developed to such an extent that the market will ensure just and reasonable rates.[361]

274. Second, our market-based approach is an eminently reasonable method for pursuing our goal of promoting competition and ensuring the economically efficient pricing of interstate access services. As competition emerges, the market-based approach will permit access charges to move towards the levels that will prevail in competitive markets. During the transition to competitive markets, access services not subject to competition will remain subject to price cap regulation, and we will eventually prescribe rates for those services at forward-looking economic cost levels, to ensure that all consumers reap the benefits of economically-efficient prices. Unlike the FERC regulation at issue in *Farmers Union*, our market-based approach to promoting the development of competitive markets and economically-efficient pricing will not be based on "largely undocumented reliance on market forces . . . ."[362] Instead, we will design our approach so that deregulation occurs only when the reliability of market forces can be fully determined with respect to a particular service. Finally, we observe that FERC's mandate in *Farmers Union* was one of rate regulation due to

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[357] *Id.* at 1502.

[358] *Id.* at 1508.

[359] *Id.* at 1502.

[360] 47 U.S.C. § 201(b).

[361] Such market-based regulation of prices has been upheld where the market being relied upon is sufficiently competitive and the regulator maintains its authority to step in to ensure that rates remain just and reasonable. *Elizabethtown Gas Co. v. FERC*, 10 F.3d 866, 870-71 (D.C. Cir. 1993).

[362] AT&T Comments at 48 (*citing Farmers Union*, 734 F.2d at 1508).

market failure and concern over monopoly power.[363] In light of the 1996 Act, our mandate is no longer strictly or solely one of rate regulation. Congress has stated its desire to establish "a pro-competitive, deregulatory national policy framework."[364] Our market-based approach will be designed to coincide with and promote this objective.

275. *Price Squeeze Concerns Are Adequately Addressed.* Several parties have argued that current access charge rate levels create the conditions for an anticompetitive price squeeze when a LEC affiliate offers interexchange services in competition with IXCs.[365] A price squeeze, as the term is used by these parties, refers to a particular, well-defined strategy of predation that would involve the incumbent LEC setting "high" prices for interstate exchange access services, over which the LEC has monopoly power (albeit constrained by regulation), while its affiliate is offering "low" prices for long-distance services in competition with the other long-distance carriers. Because interstate exchange access services are a necessary input for long-distance services, these parties argue that an incumbent LEC can create a situation where the relationship between the LEC's "high" exchange access prices and its affiliate's "low" prices for long-distance services forces competing long-distance carriers either to lose money or to lose customers even if they are more efficient than the LEC's affiliate at providing long-distance services. It is this nonremunerative relationship between the input prices and the affiliate's prices, and not the absolute levels of those prices, that defines a price squeeze. In the most extreme case, a price squeeze involves a monopolist setting input prices that are actually higher than its prices in the output market.

276. Price cap regulation of access prices limits the ability of LECs to raise the prices of the input services. Commenters raising price squeeze concerns argue, however, that a LEC's interexchange affiliate will still be in a position to implement a price squeeze by setting long-distance rates close to the rates for access services, thereby forcing IXCs to charge below-cost rates to retain customers. They argue that LECs' interexchange affiliates have lower costs of providing interexchange services because of their affiliation with monopoly providers of interstate access services, and not as a result of being more efficient. According to these commenters, the relevant economic costs of providing interstate interexchange services will be lower for the LEC affiliate offering interexchange services than for competing IXCs because it only has to recover the true economic cost of providing the interstate access services (since the owners of the LEC and its interexchange affiliate will want the two entities to maximize their joint profits), whereas the IXCs will be forced to pay interstate access charges that are above the true economic cost of providing the underlying services.

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[363] *Farmers' Union*, 734 F.2d at 1508.

[364] *Joint Explanatory Statement*.

[365] Appendix B, Section IV.A, *infra*.

277. Absent appropriate regulation, an incumbent LEC and its interexchange affiliate could potentially implement a price squeeze once the incumbent LEC began offering in-region, interexchange toll services. Although no BOC affiliate may offer such services at this time, GTE, SNET, Sprint and other incumbent LECs do have affiliates offering such services. The incumbent LEC could do this by raising the price of interstate access services to all interexchange carriers, which would cause competing in-region carriers to either raise their retail rates to maintain their profit margins or to attempt to maintain their market share by not raising their prices to reflect the increase in access charges, thereby reducing their profit margins. If the competing in-region, interexchange providers raised their prices to recover the increased access charges, the incumbent LEC's interexchange affiliate could seek to expand its market share by not matching the price increase. The incumbent LEC affiliate could also set its in-region, interexchange prices at or below its access prices. Its competitors would then be faced with the choice of lowering their retail rates for interexchange services, thereby reducing their profit margins, or maintaining their retail rates at the higher price and risk losing market share.

278. We conclude that, although an incumbent LEC's control of exchange and exchange access facilities may give it the incentive and ability to engage in a price squeeze, we have in place adequate safeguards against such conduct. The *Fifth Competitive Carrier Report and Order*[366] requirements aid in the prevention and detection of such anticompetitive conduct. In our recent *In-Region Interexchange Order* we decided to retain the *Fifth Competitive Carrier Report and Order* separation requirements for incumbent LEC provision of in-region interLATA services.[367] These requirements apply both to BOCs and to other incumbent LECs. In addition, as discussed in that order, BOC interexchange affiliates are subject to the safeguards set forth in section 272 of the Act.[368]

279. The *Fifth Competitive Carrier Report and Order* separation requirements have been in place for over ten years, and independent (non-BOC) incumbent LECs have been providing in-region, interexchange services on a separated basis with no substantiated complaints of a price squeeze. Under these separation requirements, incumbent LECs are required to maintain separate books of account, permitting us to trace and document improper allocation of costs and/or assets between a LEC and its long-distance affiliate, as well as to

[366] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Fifth Report & Order, 98 FCC 2d 1191, 1198 ¶ 9 (1984) (*Fifth Competitive Carrier Report and Order*).

[367] *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, __ FCC Rcd ____, FCC 97-142 (Apr. 18, 1997) (*Dom/Nondom R&O*)

[368] *Id.*

detect discriminatory conduct. In addition, we prohibit joint ownership of facilities, which further reduces the risk of improper allocations of the costs of common facilities between the incumbent LEC and its interexchange affiliate, as discussed at length in the *In-Region Interexchange Order*[369] and the *Non-Accounting Safeguards Order* (addressing the Act's prohibition of BOC joint ownership with its interexchange affiliate pursuant to Section 272).[370] As we also discussed at length in those orders, the prohibition on jointly-owned facilities also helps to deter any discrimination in access to the LEC's transmission and switching facilities by requiring the affiliates to follow the same procedures as competing interexchange carriers to obtain access to those facilities. Finally, our requirement that incumbent LECs offer services at tariffed rates, or on the same basis as requesting carriers that have negotiated interconnection agreements pursuant to section 251[371] reduces the risk of a price squeeze to the extent that an affiliate's long-distance prices would have to exceed their costs for tariffed services.

280. Current conditions in markets for interexchange services give us comfort that an anticompetitive price squeeze is unlikely to occur as a result of our decision not to prescribe immediately access charge rates at forward-looking economic cost levels. If an incumbent LEC does attempt to engage in an anticompetitive price squeeze against rival long-distance providers, the provisions of the Act should permit new entrants or other competitors to seek out or provide competitive alternatives to tariffed incumbent LEC access services. For example, under the provisions of section 251,[372] a competitor will be able to purchase unbundled network elements to compete with the incumbent LEC's offering of local exchange access. Therefore, so long as an incumbent LEC is required to provide unbundled network elements quickly, at economic cost, and in adequate quantities, an attempted price squeeze seems likely to induce substantial additional entry in local markets. Accordingly, there should be a reduced likelihood that an incumbent LEC could successfully employ such a strategy to obtain the power to raise long-distance prices to the detriment of consumers.

281. Furthermore, even if a LEC were able to allocate improperly the costs of its

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[369] *Id.* ¶¶ 163-69.

[370] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended,* First Report and Order and Further Notice of Proposed Rulemaking, FCC 96-489 ¶¶ 159-62 (Dec. 24, 1996) (*Non-Accounting Safeguards Order*), *on recon.*, FCC 97-52 (Feb. 19, 1997), *recon. pending*, CC Docket No. 96-149, *petition for summary review in part denied and motion for voluntary remand granted sub nom., Bell Atlantic v. FCC*, No. 97-1067 (D.C. Cir. filed Mar. 31, 1997), *petition for review pending sub nom., SBC Communications v. FCC*, No. 97-1118 (D.C. Cir. filed Mar. 6, 1997) (held in abeyance pursuant to court order filed May 7, 1997).

[371] *Id.* ¶ 164.

[372] 47 U.S.C. § 251(c)(3).

affiliate's interexchange services, we conclude that it is unlikely that the LEC's interexchange affiliate could engage successfully in predation.[373] At least four interexchange carriers -- AT&T, MCI, Sprint, and LDDS WorldCom -- have nationwide, or near-nationwide, network facilities that cover every LEC's region.[374] These are large, well-established companies with millions of customers throughout the nation. It is unlikely, therefore, that one or more of these national companies can be driven from the market with a price squeeze, even if effectuated by several LECs simultaneously, whether acting together or independently. Even if it could be done, it is doubtful that the LECs' interexchange affiliates would later be able to raise, and profitably sustain, prices above competitive levels. As Professor Spulber has observed, "[e]ven in the unlikely event that [LECs' interexchange affiliates] could drive one of the three large interexchange carriers into bankruptcy, the fiber-optic transmission capacity of that carrier would remain intact, ready for another firm to buy the capacity at distress sale and immediately undercut the [affiliates'] noncompetitive prices."[375]

282. Finally, in addition to our regulations and the provisions of section 251 of the Act, the antitrust laws also offer a measure of protection against a possible price squeeze.[376] Although we believe it would not serve the public interest for us knowingly to permit a price squeeze to occur, and to rely entirely on the adequacy of antitrust law remedies to protect the public, we take comfort in the fact that such remedies exist should an anticompetitive price

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[373] *See Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986) ("[P]redatory pricing schemes are rarely tried, and even more rarely successful.").

[374] *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271, 3304 ¶¶ 60-61 (1996).

[375] Daniel F. Spulber, *Deregulating Telecommunications*, 12 Yale J. Reg. 25, 60 (1995).

[376] Beginning with Judge Learned Hand's opinion in *United States v. Aluminum Co. of America (Alcoa)*, 148 F.2d 416, 437-38 (2d Cir. 1945), a specific body of precedent has developed under federal antitrust law defining situations where a price squeeze can be actionable as a form of monopolization or attempted monopolization under Section 2 of the Sherman Act. 15 U.S.C. § 2. Under this precedent, a price squeeze can violate the antitrust laws where (1) a firm has monopoly power with respect to an "upstream" product; (2) it sells that product at "higher than a 'fair price,'"; (3) the product is a necessary input for the product being sold by other firms in competition with the monopoly or its affiliate in a "downstream" market; and (4) the monopolist offers the "downstream" product at a price so low that (equally-efficient) competitors cannot match the price and still earn a "living profit." *Alcoa*, 148 F.2d at 437-38. Over time, courts have developed several tests for determining when the relationship between the two prices is sufficiently adverse to competitors that it constitutes an anticompetitive price squeeze. *See, e.g., Bonjorno v. Kaiser Aluminum & Chem. Corp.*, 752 F.2d 802, 808-09 (3d Cir. 1984), *cert.denied*, 477 U.S. 908 (1986); *Ray v. Indiana & Mich. Elec. Co.*, 606 F. Supp. 757, 776 (N.D. Ind. 1984), *aff'd*, 758 F.2d 1148 (7th Cir. 1985).

squeeze occur in spite of the safeguards we have adopted.[377] In particular, although a price squeeze engaged in by several LECs, particularly if it involved more than one of the BOCs or GTE, could have a significant impact on interexchange competitors, we believe that the antitrust laws will act as a strong backstop to our own enforcement process so that the risk of such concerted activity is sufficiently limited.[378]

283. *Other Concerns Raised by Commenters*. Several commenters raised concerns that our market-based approach to access charge reform might permit incumbent LECs to engage in cross subsidization, either between competitive and non-competitive services, or between interstate access services and other services such as video distribution.[379] No evidence has been presented, however, indicating any likelihood that current price cap regulation, which is designed, in part, to prevent cross subsidization, might become less effective under a market-based approach to access charge reform. Those price cap regulations will remain in place until there is sufficient competition to prevent an incumbent LEC from charging rates that are not just and reasonable. Therefore, we find that the record does not contain substantial evidence that a market-based approach to access charge reform is any less likely than current regulation to permit incumbent LECs to engage in unreasonable cross subsidization with their interstate access charges.

284. Finally, several commenters based their support for a market-based approach, in part, on arguments that it would reduce, or minimize, administrative burdens. Other commenters, on the other hand, opposed a market-based approach on the grounds that it would increase administrative burdens. Based on the record before us, however, we cannot reach a conclusion as to the relative administrative burdens of the two approaches. Some parts of our proposed market-based approach, such as grants of increased pricing flexibility as competitive conditions warranted, were modeled on waivers that we have granted within the context of our current price cap plan and would likely be necessary even if we had adopted a primarily prescriptive approach to access charge rate level reform. Similarly, some parts of a prescriptive approach, such as annual changes in price cap calculations, will necessarily be a part of our market-based approach. Accordingly, we can see no basis in this record for concluding that a market-based approach to access charge reform will be any more or less

[377] Because the rates charged by LEC interexchange affiliates will not be regulated, we do not believe that a court would reject a price squeeze claim under the antitrust laws on the grounds that "'normally' a price squeeze will not constitute an exclusionary practice in the context of a fully regulated monopoly." *Town of Concord v. Boston Edison Co.*, 915 F.2d 17 (1st Cir.1990) (J. Breyer), *cert. denied*, ___ U.S. ___, 111 S. Ct. 1337 (1991). Indeed, the court in that case explicitly declined to address the "special problem" posed by a price squeeze allegation against a firm regulated in the input market and undercutting rivals' prices in the unregulated market where inputs are used. *Id.* at 29.

[378] *See Non-Accounting Safeguards Order* FCC 97-142 ¶ 70.

[379] *See* Appendix B, Section IV.A, *infra*.

burdensome than any other alternative.

B. Prescriptive Approaches

1. Prescription of a New X-Factor

a. Background

285. In the NPRM, we observed that the Commission had initiated a rulemaking proceeding in the *Price Cap Fourth Further NPRM* to examine a number of proposals for revising the productivity offset component of the X-Factor, and to consider related issues such as eliminating sharing obligations and the low-end adjustment mechanism.[380] We invited parties to discuss in this proceeding whether the record developed pursuant to the *Price Cap Fourth Further NPRM* justified increasing the productivity offset, and specifically invited comment on the effects of a forward-looking cost of capital and economic depreciation on total factor productivity (TFP) measurement.[381]

b. Discussion

286. The commenters generally repeat arguments made in the *Price Cap Fourth Further NPRM* proceeding. For reasons explained in detail in our companion *Price Cap Fourth Report and Order*, we conclude that we should prescribe an X-Factor on the basis of total factor productivity studies, the difference between LEC input price changes and input price changes in the economy as a whole, and the 0.5 percent consumer productivity dividend (CPD). In the companion order we find that this results in an X-Factor prescription of 6.5 percent.

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[380] NPRM at ¶ 233. With respect to the productivity offset, we invited comment on, among other things, basing it on total factor productivity (TFP). TFP is the ratio of an index of a firm's total outputs to an index of its total inputs. NPRM at ¶ 233 n.300, *citing Price Cap Fourth Further NPRM*, 10 FCC Rcd at 12663-71. With respect to sharing, we noted that, although sharing tends to blunt the efficiency incentives otherwise created by the price cap plan, it also serves beneficial functions, and we invited comment on eliminating sharing and establishing other mechanisms to serve those functions. NPRM at ¶ 233 n.301, *citing Price Cap Fourth Further NPRM*, 10 FCC Rcd at 12676-80.

[381] NPRM at ¶ 233. GTE notes that, while the X-Factor received considerable attention in the *Price Cap Fourth Further NPRM* proceeding, the discussion did not focus on the effects of the 1996 Act. GTE Comments at 57.

2. Other Prescriptive Approaches

a. Background

287. In the NPRM, we sought comment on four options for a prescriptive approach: reinitializing price cap indices (PCIs) to economic cost-based levels;[382] reinitializing PCIs to levels targeted to yield no more than an 11.25 percent rate of return, or some other rate of return;[383] adding a policy-based mechanism similar to the CPD to the X-Factor;[384] or prescribing economic cost-based rates.[385] We have decided above to rely primarily on a market-based approach, and impose prescriptive requirements only when market forces are inadequate to ensure just and reasonable rates for particular services or areas. We will determine the details of our market-based approach in a future Order. In that Order, we will also discuss in more detail what prescriptive requirements we will use as a backstop to our market-based access charge reform.[386] In this Section, we explain why we have decided not to adopt any specific prescriptive mechanism in this Order.

b. Rate Prescription

288. *Background.* We sought comment on prescribing new interstate access rates because simply reinitializing PCIs would not necessarily compel incumbent LECs to establish reasonable rate structures.[387] We also noted, however, that prescribing access rates on a TSLRIC basis could raise common cost allocation issues to a much greater extent than did TELRIC pricing for unbundled network elements.[388]

289. *Discussion.* In Section IV.A, above, we explain why we can and should rely primarily on market forces to cause interstate access rates to move toward economic cost levels over the next several years. Prescribing TSLRIC-based access rates would be the most direct, uniform way of moving those rates to cost. But, precisely because of its directness and

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[382] NPRM at ¶¶ 223-27.

[383] NPRM at ¶¶ 228-30.

[384] NPRM at ¶¶ 231-32.

[385] NPRM at ¶¶ 236-38.

[386] In Section IV.A of this Order, we state that we will require incumbent price cap LECs to file forward-looking economic cost studies on or before February 8, 2001.

[387] NPRM at ¶ 236.

[388] NPRM at ¶ 237.

uniformity, rate regulation can only be, at best, an imperfect substitute for market forces. Regulation cannot replicate the complex and dynamic ways in which competition will affect the prices, service offerings, and investment decisions of both incumbent LECs and their competitors. A market-based approach to rate regulation should produce, for consumers of telecommunications services, a better combination of prices, choices, and innovation than can be achieved through rate prescription. A market-based approach, with continued price cap regulation of services not subject to substantial competition and with the prescriptive backstop described in Section IV.A, is thus consistent both with the pro-competitive, deregulatory goals of the 1996 Act and with our responsibility under Title II, Part I of the Communications Act to ensure just and reasonable rates.

290. Furthermore, immediate prescription of TSLRIC-based rates would not necessarily move rates to those levels faster than the market-based approach and prescriptive backstop developed in Section IV.A. Some parties that favor a prescriptive approach have asserted that setting access rates immediately at TSLRIC levels would reduce incumbent LEC revenues by $10 billion or more.[389] Were we to make such a rate prescription, we would consider phasing in rate reductions of that magnitude over a period of years, in order to avoid the rate shock that would accompany such a great rate reduction at one time.[390] Finally, because we have adopted a more efficient rate structure for interstate switched access services, it is not necessary to prescribe new rates in order to achieve efficient rate structures, as TRA and TCI recommend. Accordingly, we will not prescribe TSLRIC-based access rates at this time.

c. Reinitialization of PCIs on a Rate-of-Return Basis

291. *Discussion.* We reject reinitialization on the basis of any rate of return at this time. As a general matter, the parties advocating a rate-of-return based reinitialization do not provide any persuasive reason for adopting that particular approach. They favor reinitialization largely because they believe interstate access charges should be lower than they are now. As explained above, however, we are adopting a primarily market-based approach to rate level adjustments. The prescriptive backstop to that approach will be based on TSLRIC cost studies and, most likely, applied to geographically deaveraged rates. That approach is more likely to result in rates that are aligned with economic costs than would reinitialization to a particular rate of return on an embedded cost rate base.

292. Moreover, because the basic theory of our existing price cap regime is that the prospect of retaining higher earnings gives carriers an incentive to become more efficient, we

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[389] *See* NPRM at ¶ 7 and sources cited therein.

[390] *See Investigation of Special Access Tariffs of Local Exchange Carriers*, CC Docket No. 85-166, Phase I and Phase II, Part 1, FCC 84-524, 57 Rad.Reg. 2d 188, 209 (released Nov. 9, 1984).

believe that rate of return-based reinitialization would have substantial pernicious effects on the efficiency objectives of our current policies.[391] In this regard, we have often expressed concern in past price cap orders that maintaining links between rate levels and a carrier's achieved rate of return would undercut the efficiency incentives price cap regulation was designed to encourage. In the *LEC Price Cap Order*, we rejected a so-called "automatic stabilizer" adjustment to the price cap index that -- like reinitialization -- would have permanently adjusted index levels downward in the event that carriers achieved earnings above a certain rate of return.[392] Similarly, in our 1995 *LEC Price Cap Performance Review Order*, we cited as a disadvantage of AT&T's "Direct Model" method of determining the PCI formula's "X-Factor" the fact that "a target rate of return is a critical factor in measuring productivity."[393] And although we sought comment in the *Access Reform NPRM* on the question of rate of return-based reinitialization of the price cap indices, we once again expressed concern that such action "could have a negative effect on the productivity incentives of the LEC price cap plan."[394] We, of course, have authority to change our methods and theories of regulating LEC rates when we believe the purposes of the Communications Act would be better served by doing so. However, we find that, given our consistently critical past statements about rate of return-based adjustments to price caps, a decision now to reinitialize PCIs to any specified rate of return would further undermine future efficiency incentives by making carriers less confident in the constancy of our regulatory policies.

293. In declining to reinitialize PCIs on the basis of carriers' rates of return, we reject GSA/DOD's suggestion that access rates have been excessive merely because the earnings of most price cap carriers have exceeded 11.25 percent, and, in some cases, by substantial amounts. When the Commission adopted price cap regulation, it specifically permitted price

[391] Ad Hoc's suggestion that we require a PCI reinitialization based on the currently-authorized 11.25 percent rate of return -- while administratively simpler than some other ways of changing rate levels -- would undermine productivity incentives by imposing the greatest penalties (rate reductions) on those carriers that had improved their efficiency the most. Reinitialization to another rate of return level, as API suggests, could, in addition, require resolution of complex and time-consuming issues. *See, e.g.*, Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, CC Docket No. 89-624, 5 FCC Rcd 7507 (1990) (taking about a year to resolve all relevant issues raised in prescribing the currently-authorized 11.25 percent rate of return).

[392] *LEC Price Cap Order*, 5 FCC Rcd at 6803. We adopted instead a sharing mechanism that made one-time earnings-related adjustments to PCI levels to ensure that carriers would "share" significant productivity gains in a given year with ratepayers, but would not be penalized by permanent downward adjustments to the track that the PCI otherwise would have taken. We have found that even the sharing mechanism tends to blunt efficiency incentives, and, in part for that reason, we are removing the sharing mechanism as well in Section IV of our companion *Price Cap Fourth Report and Order*.

[393] *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 9034.

[394] NPRM at ¶ 230.

cap carriers to earn in excess of 11.25 percent in order to encourage them to become more productive.[395] The Commission also concluded that complaints alleging excessive earnings relative to costs will not lie as long as the carrier is in compliance with the sharing mechanism.[396] In addition, we found in the *LEC Price Cap Performance Review Order* that access rates declined substantially under price cap regulation from 1991 to 1994, in spite of the increases in earnings to which GSA/DOD alluded.[397] Furthermore, the vastly different results among companies[398] show that the incentive plan we have for cost reduction (price caps) largely is working as predicted, whereas a rate-of-return-based scheme would have cost much in terms of inefficiency.

d. Reinitialization of PCIs on a TSLRIC Basis

i. Background

294. In the NPRM, we sought comment on reducing price cap PCIs by an amount equal to the difference between the incumbent LECs' PCIs and the revenues that would be produced by rates set at TSLRIC levels. We noted that a TSLRIC-based PCI reinitialization might be preferable to a TSLRIC-based rate prescription because it would not require us to prescribe common cost allocations.[399] We also sought comment on whether or to what extent we could rely on TELRIC studies developed for pricing unbundled network elements, and whether we should initiate joint board proceedings to rely on state commissions to evaluate the incumbent LECs' TELRIC studies.[400]

ii. Discussion

295. We have decided not to require incumbent LECs to reinitialize PCIs on a TSLRIC basis at this time. As we discuss in Section IV.A above, we expect market forces to develop as a result of the 1996 Act and to drive access rate levels to forward-looking economic costs. Furthermore, the record in this proceeding is unclear on whether there is an

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[395] *LEC Price Cap Order*, 5 FCC Rcd at 6787.

[396] *LEC Price Cap Order*, 5 FCC Rcd at 6836.

[397] We found that the cumulative effect of price cap regulation from 1991 to 1994 was approximately $5.9 billion. *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 8986-87. We do not know for certain, but believe that the benefits to access customers would have been smaller under rate-of-return regulation.

[398] *See, e.g.*, 1996 Annual Access Filings, 11 FCC Rcd 7564 (Com.Car.Bur. 1996).

[399] NPRM at ¶ 223.

[400] NPRM at ¶¶ 224-25.

accurate and convenient method for determining TSLRIC for purposes of reinitializing PCIs at this time. Specifically, it is unclear whether the TELRIC studies used to develop unbundled network element prices can be used for access services.[401]

e. Policy-Based X-Factor Increase

i. Background

296. In the NPRM, we observed that we adopted a consumer productivity dividend (CPD) to assure that some portion of the benefits of the incumbent LECs' increased productivity growth under price cap regulation would flow to ratepayers in the form of reduced rates. We sought comment on establishing a policy-based mechanism similar to the CPD to force access rates to cost-based levels.[402]

ii. Discussion

297. *Discussion.* We do not require a policy-based X-Factor increase at this time for the same reason we do not require a TSLRIC-based PCI reinitialization; we expect market forces to control access charges effectively in a less intrusive manner.

298. BellSouth and GTE oppose increasing the CPD as an arbitrary and confiscatory measure.[403] SNET claims that increasing the X-Factor merely because the price cap LECs have earned too much, or simply to drive rates down, is essentially an abandonment of price cap regulation, because it would punish incumbent LECs for their efficiency gains made under the price cap regime.[404] BA/NYNEX and GTE contend that the X-Factor should be chosen to reflect reasonably expected incumbent LEC productivity growth rather than to achieve a specific rate reduction.[405] We emphasize that we have done nothing in this Order to increase the X-Factor. In our companion *Price Cap Fourth Report and Order*, we prescribe a new X-Factor of 6.5 percent, but this prescription is based on detailed studies of LEC productivity growth and input price changes.[406] We decline to increase the CPD,[407] and we reject a

[401] *Universal Service Order* at ¶ 245.

[402] NPRM at ¶¶ 231-32.

[403] BellSouth Comments at 49; GTE Comments at 77-78.

[404] SNET Reply at 23-24. *See also* BA/NYNEX Reply at 32-33.

[405] BA/NYNEX Reply at 30; GTE Reply at 26-27.

[406] *Price Cap Fourth Report and Order*, Section III.E.

proposal to set the X-Factor to target an industry average rate of return of 11.25 percent.[408] Thus, none of our actions in either this Order or our companion Order can properly be characterized as an abandonment of price cap regulation, or as motivated merely by a desire to drive rates down.

C. Equal Access Costs

1. Background

299. In the NPRM, we solicited comment on whether to require incumbent price cap LECs to make an exogenous cost decrease to one or more of their PCIs to account for the completion of the amortization of equal access costs on December 31, 1993.[409]

300. Under court order, the BOCs and GTE were required to provide equal access.[410] This conversion, estimated at more than $2.6 billion, was largely completed by 1990, and involved both capital and non-capital expenditures. Under the *Equal Access Cost Order*, incumbent LECs were required to identify separately the incremental capital investments and the incremental non-capital-related expenses associated with the implementation of equal access. The *Equal Access Cost Order* directed that the capital investments, which it estimated to comprise approximately 55 percent of the $2.6 billion, be treated pursuant to ordinary accounting and ratemaking principles.[411] The Commission determined that the remaining 45 percent of the expenditures -- which were non-capitalized equal access expenses -- required

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[407] *Price Cap Fourth Report and Order*, Section III.D.5.

[408] *Price Cap Fourth Report and Order*, Section III.B.

[409] NPRM at ¶ 293. We note that through the years, this issue has been referred to as "equal access network reconfiguration" or EANR costs. This is a misnomer, which we correct today. "Equal access" is the provision of exchange access to all interexchange carriers on an unbundled, tariffed basis that is equal in type, quality, and price to that provided to AT&T and its affiliates. *Equal Access and Network Reconfiguration Costs, Memorandum Opinion and Order*, 50 Fed. Reg. 50910 (rel. Dec. 9, 1985) at ¶ 18 (*Equal Access Cost Order*). "Network Reconfiguration" costs are those investments and expenses incurred in connection with structurally conforming the pre-divestiture AT&T network with the LATA boundaries mandated by the MFJ. *Id.* Issues underlying network reconfiguration costs were resolved in the *Equal Access Cost Order* and have not been raised since. *See Id.* at ¶ 22.

[410] *See United States v. AT&T*, 552 F. Supp. 131, 233 (D.D.C. 1982); *United States v. GTE Corp.*, 603 F. Supp. 730, 745 (D.D.C. 1984).

[411] *Equal Access Cost Order*, 50 Fed. Reg. at 50914, ¶ 32 ("[W]e believe that the capital cost of equal access service is best measured in the traditional manner whereby the cost of investments are recovered over their useful lives. This is best accomplished by using FCC prescribed depreciation lives for the classes of property associated with equal access.").

special treatment:

> [W]e are concerned that these expenditures will cause irregular and substantial fluctuations in revenue requirements associated with equal access. Because they are extraordinary, are for the greatest part expected to be incurred over the next few years, and, therefore, are likely to be distortive of financial results and rate requirements, we find that these equal access expenses should be deferred and amortized.[412]

The Commission ordered that these equal access expenses be separately identified and recorded, and that they be written off over a period of eight years, ending December 31, 1993.[413] In the reconsideration of the *Equal Access Cost Order*, the Commission found that the specific termination date of the eight year amortization of these expenses would "shorten the period during which the unamortized balances are entitled to earn a rate of return."[414] It is clear that the LECs' rate-of-return (ROR) rates included revenue recovery for both capitalized expenditures (recovered through the ordinary depreciation process) and non-capitalized expenses (recovered through the special amortization process).[415] It is also clear that at the time the amortization was imposed, the Commission envisioned an end to the recovery for the amortized expenses and a subsequent decrease in ROR rates.[416]

301. In converting to price cap regulation, the Commission found that equal access conversion was, in large part, completed and that the associated costs, which included both the capitalized expenditures and the amortized expenses, were embedded in the existing rates. As such, the Commission refused to grant LECs an exogenous increase for equal access costs, finding that these costs were already accounted for in the existing rates.[417] The Commission also based its decision to deny an exogenous increase on its concern that exogenous treatment of equal access expenditures would create inappropriate incentives for the LECs to inflate the amounts spent on equal access. The Commission noted the difficulty of reviewing equal access costs, as well as the risk that incumbent LECs might willfully or inadvertently shift switched access costs into the proposed equal access category in order to benefit from the

412 *Equal Access Cost Order*, 50 Fed. Reg. at 50914-15, ¶ 33.

413 *Equal Access Cost Reconsideration Order*, at 437 ¶ 25.

414 *Equal Access Cost Reconsideration Order*, at 437 ¶ 25.

415 *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 180.

416 *Equal Access Cost Reconsideration Order*, at 437 ¶ 25.

417 *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 180.

requested exogenous increase.[418]

2. Discussion

302. We find that an exogenous cost decrease to account for completion of the amortization of equal access non-capitalized expenses is necessary and appropriate. Although we have addressed this issue in the past and declined to act, we now find that an exogenous decrease is merited. We recognize our decision departs from our past decisions that have declined to impose an exogenous decrease for the completed recovery of these costs. As discussed below, our decision today reverses those decisions and is based on an extensive record from this, and prior proceedings.[419] Our decision today aligns our treatment of the completion of the amortization of equal access costs with two other similar amortizations that were ordered under ROR regulation and carried over into price cap regulation, namely, the exogenous decrease imposed for the completion of the amortization of depreciation reserve deficiencies,[420] and the exogenous decrease imposed for the completion of the amortization of inside wire costs.[421] We are convinced that this treatment is the proper method to ensure that ratepayers are not paying for costs that have already been completely recovered.

303. The need for an exogenous adjustment to account for the expiration of the equal access expense amortization stems from the different ways in which rates are established under ROR regulation, on the one hand, and price cap regulation, on the other hand, and from the Commission's decision to establish initial price cap levels at the outset of price cap regulation on the basis of existing ROR-derived rates.[422] When converting from ROR

[418] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 180.

[419] In addition to the comments received in this proceeding, our record is supplemented by commentary from interested parties in a number of prior proceedings, including comments filed in connection with the following orders: *LEC Price Cap Order*, 5 FCC Rcd 6786 (1990); *LEC Price Cap Reconsideration Order*, 6 FCC Rcd 2637 (1991); *Commission Requirements for Cost Support Material To Be Filed with 1994 Annual Access Tariffs*, 9 FCC Rcd 1060; *1994 First Annual Access Tariff Order*, 9 FCC Rcd 3705; *Second 1994 Annual Access Order*, 9 FCC Rcd 3519; *1993-1996 Annual Access Tariff Filings*, CC Docket Nos. 93-193 and 94-65, Memorandum Opinion and Order, FCC 97-139 (rel. April 17, 1997).

[420] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 173.

[421] *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2673-2674, ¶¶ 78-82 (imposing exogenous cost decrease for the completion of amortization of inside wire costs).

[422] Under ROR regulation, rates for a particular service are determined annually by a calculation from the ground up of the company-specific costs associated with the provision of that service. Expenses generally are recovered in their entirety through rates in the year in which they are incurred. Asset costs generally are capitalized and recovered over the assets' useful lives through rates that are designed to reflect the annual depreciation expenses associated with the assets and a return on the undepreciated (remaining) portion of the

regulation to price cap on regulation January 1, 1991, the Commission needed to select a set of "baseline" rate levels to which the price cap index of incremental cost changes would be tied. For that purpose, we chose the ROR-developed rates that were in effect on July 1, 1990.[423] The Commission found that, in general, those rates served as an appropriate starting point for measuring subsequent incremental cost changes under price cap regulation, because they "reflect[ed] the reasonable operation of ROR regulation."[424]

304. In two respects, however, the Commission recognized that existing rates did not reflect equilibrium ROR-derived rates, but rather reflected special corrective adjustments that we had ordered previously. In particular, the Commission noted that existing rates had embedded within them costs associated with Commission-ordered "one-time" amortizations of depreciation reserve deficiencies and inside wiring costs.[425] Had ROR regulation continued, the rates subject to these amortizations would have been reduced when the amortizations were completed. To ensure that ratepayers under price caps would not be required permanently to bear these temporary Commission-ordered, ROR-derived rate adjustments, we directed LECs to make downward exogenous cost adjustments to their price cap indices upon the expiration of those amortizations.[426]

305. Similarly, the Commission ordered amortization of equal access expenses, which also were reflected in baseline rates at the outset of price cap regulation. Under normal ROR ratemaking principles, those expenses -- which, for the most part, already had been incurred

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assets. Under price caps, rates are not developed each year through a "ground up" calculation of company-specific costs. Instead, rates are set according to a formula that measures the incremental change in costs each year -- as reflected (a) in the movement of surrogates (*i.e.*, GDP-PI minus X) for so-called "endogenous" costs over which the carrier can exercise some control, and (b) in the company-specific measurement of certain "exogenous" cost changes that are not reflected in the "GDP-PI minus X" variable and are beyond the carriers' control.

[423] *LEC Price Cap Order*, 5 FCC Rcd at 6814, ¶ 230.

[424] *Id.* at ¶ 232.

[425] *See Price Cap Further Notice of Proposed Rulemaking*, 3 FCC Rcd at 3419-23 ¶¶ 413-420. The depreciation reserve deficiency amortization was a "one-time correction device" ordered by the Commission to address the fact that the depreciation rates prescribed by the Commission had significantly overstated the useful lives of LEC assets. The Commission temporarily raised LEC rates to recover that deficiency. *Price Cap Further Notice*, 3 FCC Rcd at 3421-22, ¶¶ 417-18. The inside wiring amortizations provided a mechanism for LECs to recover from regulated ratepayers investments in activities that were regulated at the time the investments were made, but which the Commission had deregulated on a going-forward basis. *Id.*, 3 FCC Rcd at 3422-23, ¶¶ 419-420.

[426] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 173; *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2673-74, ¶¶ 78-80.

before price cap regulation was initiated -- would have been recovered in the BOCs' rates the same year they were incurred and would no longer have been reflected in rates at the time price caps were instituted. However, as explained *supra*, the Commission required the carriers to amortize these extraordinary expenses over eight years because of the potential fluctuations in revenue requirements associated with equal access.[427] Thus these expenses remained embedded within BOC rates at the outset of price caps even though, for the most part, the extraordinary expenses themselves were no longer being incurred.

306. The specific question of whether the completely amortized equal access expenses should be treated exogenously has been presented to the Commission on a number of occasions.[428] In the past, procedural impediments arising from our rules, as well as the lack of an adequate record, convinced us to decline to impose such treatment at that time. For example, when AT&T raised the issue of downward adjustment for completed amortization of equal access expenses in an annual access charge tariff proceeding, the Common Carrier Bureau found that the issue was beyond the scope of the proceeding because it would require a substantive change to the price cap rules.[429] Similarly, in response to AT&T's and MCI's revisiting the question in both the *First 1994 Annual Access Charge Order* and the *Second 1994 Annual Access Charge Order*, the Commission found that exogenous treatment would require a rule change to section 61.45(d) of the Commission's rules. Because no LEC had filed for a waiver of section 61.45(d), the Common Carrier Bureau found that the issue was not properly presented for investigation.[430]

307. In denying the requests for procedural reasons, the Commission supported its decisions with various rationales. In some instances, these rationales appear now not to have been considered to a sufficient degree. In addressing equal access costs in the orders adopting price cap regulation, the Commission focused primarily on the question of whether future equal access investments and expenses should be treated exogenously because equal access

[427] *Equal Access Cost Order*, 50 Fed. Reg. at 50914-15, ¶ 33 (1985).

[428] *See, e.g.*, *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667, ¶ 66 n.77; *Commission Requirements for Cost Support Material To Be Filed with 1994 Annual Access Tariffs*, 9 FCC Rcd 1060, 1063, ¶¶ 21-22 (rel. Feb. 18, 1994) (*1994 Annual Access TRP*); *First 1994 Annual Access Charge Order*, 9 FCC Rcd 3705, 3730-37311 at ¶¶ 54-56 (rel. June 24, 1994); *Second 1994 Annual Access Charge Order*, 9 FCC Rcd 3519, 3535-3536 at ¶¶ 36-38 (rel. June 24, 1994).

[429] *1994 Annual Access TRP*, 9 FCC Rcd at 1063, ¶¶ 21-22.

[430] *See First 1994 Annual Access Charge Order*, 9 FCC Rcd at 3731; *Second 1994 Annual Access Charge Order*, 9 FCC Rcd at 3536. *See also 1993-1996 Annual Access Tariff Filings*, CC Docket Nos. 93-193 and 94-65, Memorandum Opinion and Order, FCC 97-139 (rel. April 17, 1997), at ¶ 82.

had been compelled by regulatory (or judicial) order.[431] We concluded, subject to consideration of waiver requests, that we should not accord exogenous cost treatment to such future equal access conversion costs, because of concerns that exogenous cost treatment would create disincentives to implement equal access in an efficient manner.[432] We did not focus in detail on the logically distinct question of whether equal access expenses that were already embedded within baseline BOC rates pursuant to the temporary "one-time" amortizations (and thus raised no question with respect to future incentives) should be removed through exogenous adjustments when the amortizations expired.[433] Instead, we relegated that issue to a footnote, which denied exogenous cost treatment on the basis of a skeletal analysis that makes no reference to our treatment of the depreciation reserve deficiency and inside wiring amortizations. In the footnote, it is clear that the Commission was not distinguishing between capitalized costs, which were properly treated as depreciated expenses, and non-capitalized expenses, which were actually amortized per the Commission's own requirement.[434] The Commission framed the issue of a downward adjustment in terms of whether the completion of depreciation required a downward adjustment, querying "whether the BOCs will experience any cost change in 1994 [at the completion of the amortization] that stems from factors beyond their control." In support of its implicitly negative answer, the Commission analogized to the absence of a price cap index change when a piece of equipment is fully depreciated, or when a carrier increased or decreased the speed with which it recovered investments.[435] The Commission found that, "[b]ased on a meager factual record presented on the issue of equal access expense, we are reluctant to depart from our practice of not adjusting

[431] *LEC Price Cap Order*, 5 FCC Rcd at 6808 ¶¶ 180-181. The amortization requirement had applied only to court-ordered conversion to equal access by the BOCs. The Commission, however, had also had required independent LECs to convert to equal access upon bona fide request.

[432] *See LEC Price Cap Reconsideration*, 6 FCC Rcd at 2666-67, ¶ 66.

[433] *See LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667 n.77. In several subsequent orders addressing BOC tariff filings implementing our price cap rules, we rejected contentions that we order downward exogenous cost adjustments to the carriers' price cap indexes to account for the expiration of the equal access cost amortizations. *See, e.g., 1994 Annual Access TRP*, 9 FCC Rcd at 1063, ¶¶ 21-22. We did so primarily on procedural grounds -- *i.e.*, that the treatment of such amortizations had already been decided in the price cap rulemaking proceeding and that a tariff proceeding was not the proper vehicle for changing that treatment. *Id. See also First 1994 Annual Access Charge Order*, 9 FCC Rcd at 3731; *Second 1994 Annual Access Charge Order*, 9 FCC Rcd at 3536; *1993-1996 Annual Access Tariff Filings*, CC Docket Nos. 93-193 and 94-65, Memorandum Opinion and Order, FCC 97-139 (rel. April 17, 1997), at ¶ 82.

[434] *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667, ¶ 66 n.77 ("We also decline to adopt MCI's suggestion to treat BOC equal access costs *in the same way we do amortizations*") (emphasis added).

[435] *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667, ¶ 66 n.77.

PCI levels to reflect levels of cost recovery."[436]

308. The Commission's analysis at that time was incomplete. The *Equal Access Cost Order* and the *Equal Access Cost Reconsideration Order* explicitly recognized two components of equal access costs -- capitalized, which were to be depreciated, and non-capitalized, which were extraordinary and were to be amortized over a set period.[437] The Commission established different treatment for these two sets of costs based on policy reasons, and ordered an amortization schedule for the non-capitalized costs. The Commission's establishment of this schedule was beyond the incumbent LECs' control. The Commission's analogy to the lack of exogenous treatment for equipment depreciation and changes in the tempo of recovery should have only applied to the capitalized portion of the equal access costs.

309. The Commission explicitly stated in the *LEC Price Cap Order* that completed amortizations of depreciation reserve deficiencies require an exogenous downward adjustment.[438] The Commission found that such an adjustment was necessary to ensure that ratepayers were not paying for a cost that no longer existed. Analytically, the amortized portion of equal access expenses should have been treated in the same fashion as the amortized depreciation reserve deficiency costs. The Commission's imposition of a downward exogenous adjustment for the completion of inside wire amortizations further supports our finding today that an exogenous decrease is appropriate and necessary for the completion of the amortization of equal access non-capitalized expenses.[439]

310. We reject our prior analysis of amortized equal access costs and accord the expiration of equal access cost amortizations the same exogenous cost treatment given to the amortizations of the depreciation reserve deficiencies and inside wiring costs. Both of those amortizations were given exogenous cost treatment when they expired because they reflected temporary, one-time treatment of costs under ROR regulation that, due to the mid-stream switch to price cap regulation, would have become permanent (even though the costs already had been recovered) absent an exogenous cost adjustment. The same is true for equal access cost amortizations.

311. Because this is a rulemaking, we do not face the same procedural impediments

[436] *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2667, ¶ 66 n.77.

[437] *Equal Access Cost Order*, at ¶ 33.

[438] *LEC Price Cap Order*, 5 FCC Rcd at 6808, ¶ 173 (discussing exogenous treatment of expiration of amortizations to correct depreciation reserve deficiencies).

[439] *LEC Price Cap Reconsideration*, 6 FCC Rcd at 2673-74, ¶¶ 78-82.

as in some of our prior decisions, as explained *supra*. We determine that the record from this proceeding allows us to make a reasoned decision on this issue. We find that an exogenous decrease is necessary in order to adjust the price caps for the completed recovery of the specified equal access non-capitalized expenses that we required be amortized over an eight-year period. Because the current price cap index includes an expense that has now been completely recovered, the price cap should be adjusted downward to account its recovery. Simply stated, we find that ratepayers should not be forced to pay for a cost that, were it not for the way price cap regulation occurred in this instance, they would no longer be paying. By imposing a downward exogenous adjustment to adjust the PCI for the complete recovery of specific equal access expenses through amortization, we will avoid unfairly imposing a subsidy burden on ratepayers. Our decision in this matter will align charges more closely to costs.

312. Several commenters have argued that they continue to incur costs as a part of the provision of equal access. These ongoing costs are not at issue in the present proceeding. As explained above, the costs at issue were a set of costs that the Commission determined should be amortized for policy reasons. These costs were extraordinary and, if allowed to be imposed in the normal fashion, would have resulted in huge rate fluctuations. We consider the ongoing costs of providing equal access as part of the normal costs of providing telephone service. Exogenous treatment of these costs is unnecessary. In response to BellSouth's contention that the record is inadequate for us to make a decision about an exogenous decrease, we find that the current record provides a sufficient basis for our decision.[440] Furthermore, we note that in the past, the record may have been sufficient, but, as explained above, the Commission's analysis was incorrect.

313. TCA and GCI are concerned about how the Commission will treat cost recovery for LECs that convert to equal access in the future.[441] As we stated in the *LEC Price Cap First Report and Order*, LECs that have not received a *bona fide* request for equal access at the time they become subject to price cap regulation may request a waiver for special treatment of those special conversion costs when the time arises.[442]

314. We hereby direct price cap LECs to make a downward exogenous adjustment to the traffic sensitive basket in the Annual Access Tariff filing that takes effect on July 1, 1997 to account for the completed amortization of equal access expenses.

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[440] BellSouth Comments at 87.

[441] TCA Comments at 5-6; GCI Comments at 8.

[442] *See LEC Price Cap First Report and Order*, 4 FCC Rcd 2873, 3190 at ¶ 657.

D. Correction of Improper Cost Allocations

1. Marketing Expenses

a. Background

315. Prior to 1987, incumbent LEC marketing expenses were allocated between the interstate and intrastate jurisdictions on the basis of local and toll revenues. In 1987, a Federal-State Joint Board recommended that interstate access revenues be excluded from the allocation factor used to apportion marketing expenses between the interstate and intrastate jurisdictions because marketing expenses are not incurred in the provision of interstate access services.[443] The Commission agreed with the Joint Board's recommendation and adopted new procedures that allocated marketing expenses in Account 6610 on the basis of revenues excluding access revenues.[444] In petitions for reconsideration of the Commission's order, several incumbent LECs argued that the revised separations treatment of marketing expenses would result in a significant, nationwide shift of $475 million in revenue requirements to the intrastate jurisdiction.[445] On reconsideration, the Commission adopted for marketing expenses an interim allocation factor that includes access revenues, pending the outcome of a further inquiry by the Joint Board.[446]

316. In the NPRM, we stated that some of the difference between the price cap LECs' interstate allocated costs and forward-looking costs may be traced to past regulatory practices that were designed to shift some costs from the intrastate jurisdiction to the interstate jurisdiction in order to further universal service goals.[447] We observed that the Commission's decision in the *Marketing Expense Reconsideration Order* to allocate intrastate marketing

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[443] Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Docket No. 86-297, Recommended Decision and Order, 2 FCC Rcd 2582 (1987) (*Marketing Expense Recommended Decision*).

[444] MTS and WATS Market Structure, Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Docket Nos. 78-72, 80-286, and 86-297, Report and Order, 2 FCC Rcd 2639 (1987).

[445] MTS and WATS Market Structure, Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 78-72, 80-286, and 86-297, Memorandum Opinion and Order on Reconsideration and Supplemental Notice of Proposed Rulemaking, 2 FCC Rcd 5349, 5350 (1987) (*Marketing Expense Reconsideration Order*).

[446] *Marketing Expense Reconsideration Order*, 2 FCC Rcd at 5353. *See also* 47 C.F.R. § 36.372.

[447] NPRM at ¶ 249.

costs to the interstate jurisdiction was an example of such past regulatory practices.[448] We asked parties to comment on the extent to which the difference between price cap LECs' interstate allocated costs and forward-looking costs is a result of such decisions.[449]

b. Discussion

317. Under current separations procedures, approximately 25 percent of price cap LECs' total marketing expenses are allocated to the interstate jurisdiction.[450] We agree with parties that contend that, because marketing expenses generally are incurred in connection with promoting the sale of retail services, those expenses for the most part should be recovered from incumbent LEC retail services, which are found predominantly in the intrastate jurisdiction. Pursuant to section 410(c) of the Act, however, the Commission must refer any rulemaking proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations to a Federal-State Joint Board.[451] We intend to initiate a proceeding to review comprehensively our Part 36 jurisdictional separations procedures in the near future. We will refer this issue to the Federal-State Joint Board in CC Docket No. 80-286 for resolution as part of that comprehensive review. We therefore do not reallocate these costs between the interstate and intrastate jurisdictions at this time.

318. In the *Marketing Expense Recommended Decision*, the Joint Board stated that the inclusion of access revenues in the allocation factor for marketing expenses is unreasonable because incumbent LECs do not actively market or advertise access services.[452] Although parties contested the accuracy of this statement on reconsideration, the Commission did not assess incumbent LEC claims that the decision to exclude access revenues in the allocator for marketing expenses was based on an inaccurate perception of the extent to which LECs actively market or advertise exchange access services. The Commission instead referred marketing expense issues back to the Joint Board, with specific instruction to the parties to identify any Account 6610 marketing activities that are related to access services and any such

[448] NPRM at ¶ 249.

[449] NPRM at ¶ 254.

[450] 1996 ARMIS Access Report.

[451] 47 U.S.C. § 410(c). As noted above, when the Commission reconsidered its decision to exclude interstate access revenues from the allocation factor used to apportion marketing expenses between the interstate and intrastate jurisdictions and adopted an interim allocation factor based on both local revenues and interstate access revenues, it referred the issue back to the Federal-State Joint Board in CC Docket No. 80-286 to recommend a permanent solution. *Marketing Expense Reconsideration Order*, 2 FCC Rcd at 5353.

[452] *Marketing Expense Recommended Decision*, 2 FCC Rcd at 2589.

activities that are related to a specific jurisdiction. We continue to recognize that some expenses recorded in Account 6610 may indeed be incurred in the provision of interstate access service, and that this is an issue that must be addressed by the Joint Board when it examines the appropriate allocation factor for marketing expenses. We note, however, that the Commission did not find in the *Marketing Expense Reconsideration Order* that the Joint Board's initial conclusion in the *Marketing Expense Recommended Decision* that incumbent LECs do not market or advertise access services to be inaccurate.

319. We conclude that price cap LECs' marketing costs that are not related to the sale or advertising of interstate switched access services are not appropriately recovered from IXCs through per-minute interstate switched access charges. Pending a recommendation by the Joint Board on a new method of apportioning marketing costs between the intrastate and interstate jurisdictions, we direct price cap LECs to recover marketing expenses allocated to the interstate jurisdiction from end users on a per-line basis, for the reasons we discuss below.

320. Recovering these expenses from end users instead of from IXCs is consistent with principles of cost-causation to the extent that price cap LEC sales and advertising activities are aimed at selling retail services to end users, and not at selling switched access services to IXCs. Recovery on a per-line basis, while perhaps not precisely reflective of the manner in which marketing costs are incurred, is preferable to the current rule requiring price cap LECs to recover their marketing expenses through per-minute access charges. A price cap LEC's retail marketing costs are not caused by usage of switched access services, and its efforts to sell additional lines, vertical features, and other retail services would only indirectly cause an increase in switched access usage. Per-minute recovery of retail marketing costs thus distorts prices in the long distance and local markets in the same way as does per-minute recovery of other NTS costs.

321. In the past, price cap LEC retail marketing may have focused on the sale of optional vertical features such as call waiting and caller ID, and on features and services designed for business customers. As local competition develops, we would expect that sales expenses would be driven by the price cap LEC's need to respond to competition. In any case, it is beyond our jurisdiction to reassign retail marketing costs to retail services on a truly cost-causative basis. There is probably a relationship, however, between the number of lines purchased by an end user, particularly a business user, and the amount of effort a price cap LEC expends to sell services and features to that end user. Furthermore, as parties have observed in the record in this proceeding, price cap LECs actively market second lines to residential customers.[453] We conclude, therefore, that the most efficient and cost-causative method legally available to this Commission at this time for recovery of price cap LEC retail

[453] CompuServe/Prodigy Comments at 14; America On-Line Reply at 12. *See also* Letter from Bruce K. Cox, Vice President, Government Affairs, AT&T, to William F. Caton, Acting Secretary, Federal Communications Commission, March 19, 1997.

marketing costs allocated to the interstate jurisdiction is to charge those end users to whom the price cap LECs' marketing is directed -- multi-line business and non-primary residential line end users. We further note that by not permitting price cap LECs to recover these costs from primary residential and single-line business customers, we avoid potential universal service concerns that weigh against increasing charges on these end users.[454]

322. Moreover, continued recovery of interstate-allocated marketing expenses in per-minute switched access charges would raise competitive concerns. Increasingly, IXCs will be competing with incumbent, price cap LECs in the provision of local exchange and exchange access services. By permitting incumbent, price cap LECs to recover from IXCs through interstate switched access charges their costs of marketing retail services, these potential competitors are forced to bear the incumbent, price cap LECs' costs of competing with the IXCs. Assigning recovery of marketing costs to end users, on the other hand, subjects these costs to the competitive pressures of the market.

323. Marketing expenses are currently recovered through all interstate access rate elements and the interexchange category in proportion to the investment originally assigned to these elements and categories by the Part 69 cost allocation rules.[455] Special access and interexchange services are purchased by, and marketed to, retail customers. It is therefore appropriate to allow rates for those services to continue to include recovery of marketing expenses.[456] Marketing expenses must be removed from all other rate elements by means of downward exogenous adjustments to the PCIs for the common line, traffic sensitive, and trunking baskets. With respect to the trunking basket, the exogenous adjustment shall not reflect the amount of any Account 6610 marketing expenses allocated to special access services. The service band indices (SBIs) within the trunking basket shall be decreased based on the amount of Account 6610 marketing expenses allocated to switched services included in each service category to reflect the exogenous adjustment to the PCI for the trunking basket.

324. After performing the appropriate downward exogenous adjustments described above to the PCIs in the common line, traffic sensitive, and trunking baskets, price cap LECs may recover the revenues related to the Account 6610 marketing expenses removed from these baskets by increasing the SLCs for multi-line business and non-primary residential lines.

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[454] *See* Section III.A.2, *supra*; *see also* Section V.B of the *Universal Service Order*.

[455] 47 C.F.R. § 69.403.

[456] For example, in the *SNFA Order*, we found that certain marketing expenses incurred to provide customer contact operations, service order processing, and the billing and administration of special access services are properly included in special access rates. Investigation of Special Access Tariffs of Local Exchange Carriers, CC Docket No. 85-166, Phase I; Phase II, Part 1; and Phase III, Part 1, FCC 97-42 (rel. Feb. 14, 1997) (*SNFA Order*).

To prevent end-user charges from exceeding levels we have established earlier in this Order,[457] the amount of marketing expenses to be recovered from multi-line business and non-primary residential lines in their SLCs shall be limited by the ceilings we establish for these SLCs in this Order.[458] To the extent these ceilings prevent full recovery of these amounts, price cap LECs may recover these costs by increasing equally both the non-primary residential line PICC and the multi-line business PICC, not to exceed the ceilings on the PICC for non-primary residential and multi-line business lines.[459] In the event the PICC ceilings prevent full recovery of these expenses, any residual may be recovered through per-minute charges on originating access service, subject to its ceiling. Finally, to the extent price cap LECs cannot recover their remaining marketing expenses through per-minute charges on originating access, any residual may be recovered through per-minute charges on terminating access service.[460] Although these marketing expenses will be recovered through the SLC, they shall not be included in the base factor or considered common line revenues. To prevent price cap LECs from recovering these expenses from access services, we are establishing a separate basket for these marketing expenses.

325. We reject, however, AT&T's assertion that recovery of interstate-allocated marketing expenses through interstate access charges violates the wholesale pricing provisions contained in section 252(d)(3) of the Act.[461] Section 252(d)(3) establishes a pricing standard for the wholesale provision of retail offerings to other carriers that resell the LEC retail services.[462] Section 252(d)(3) does not apply to the pricing of interstate access, which is not a retail service.

[457] *See* Section III.A.2, *supra.*

[458] In future years, these ceilings shall rise as set forth in Section III.A.2, *supra.*

[459] *See* Section III.A.3, *supra.*

[460] *See* Section VI.C, *infra*, for a discussion of terminating access.

[461] AT&T Comments at 66-67. AT&T identifies and quantifies inappropriate retail expenses embedded in current interstate switched access rates based on the requirements of section 252(d)(3) and the criteria for wholesale rate cost studies outlined in the *Local Competition Order*. *See Local Competition Order*, 11 FCC Rcd at 15958.

[462] 47 U.S.C. § 252(d)(3). Section 252(d)(3) provides that wholesale rates will be determined on the basis of retail rates, excluding the portion attributable to marketing, billing, collection, and other costs that will be avoided by the LEC.

2. General Support Facilities

a. Background

326. In the NPRM, we sought comment on other possible cost misallocations that may contribute to the difference between embedded costs and forward-looking costs allocated to the interstate jurisdiction.[463] AT&T suggests that the allocation of embedded general support facilities (GSF) costs, including general purpose computer expenses, among access categories is one such misallocation.[464] This allocation, AT&T contends, results in the inappropriate support of LECs' billing and collection service, which is a nonregulated, interstate service, through regulated access charges.[465] AT&T estimates that $124 million of expenses recovered in interstate access support the nonregulated billing and collection category.[466] Of the $124 million, $60.1 million is included in interstate switched carrier access, and $20.5 million is in interstate special access, with the remainder recovered by the SLC.[467]

327. The GSF investment category in Part 36 includes assets that support other operations, such as land, buildings, vehicles, as well as general purpose computer investment accounted for in USOA Account 2124.[468] Some incumbent LECs use general purpose computers to provide nonregulated billing and collection services to IXCs. Part 69 allocates GSF investment among the billing and collection category, interexchange category, and the access elements based on the amount of Central Office Equipment (COE), Cable and Wire Facilities (CWF), and Information Origination/Termination Equipment (IO/T) investment

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[463] NPRM at ¶ 254.

[464] For a more detailed background on GSF misallocation issues, *see* Section VII.B, *infra*.

[465] In 1986, the Commission found that the market for billing and collection service was sufficiently competitive that it was not necessary to require LECs to provide that service as a tariffed common carrier service. The Commission did not, however, preempt state regulation of billing and collection services. *See* Detariffing of Billing and Collection Services, CC Docket No. 85-88, 102 FCC 2d 1150 (1986) (*Billing and Collection Detariffing Order*) *recon. denied*, 1 FCC Rcd 445 (1986). The Commission later decided to treat billing and collection costs as regulated for accounting purposes because such treatment was less likely to misallocate these costs between the interstate and intrastate jurisdictions. Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298, 1309 (1987) (*Joint Cost Order*).

[466] AT&T Comments at 67-68, Appendix E at 2.

[467] AT&T Comments Appendix E at 2.

[468] 47 C.F.R. § 36.111.

allocated to each Part 69 category.[469] Because no COE, CWF, or IO/T investment is allocated to the billing and collection category, no investment in general support facilities, and thus no portion of general purpose computer investment, is allocated to the billing and collection category. Likewise, because expenses related to GSF investment are allocated in the same manner as GSF investment, no GSF expenses, including expenses related to general purpose computers, are allocated to the billing and collection category. To the extent that costs are underallocated to the billing and collection category, incumbent LECs' regulated services recover through interstate access charges costs associated with nonregulated provision of billing and collection services.

b. Discussion

328. We agree with AT&T and WorldCom that the current allocation of GSF costs enables incumbent LECs to recover through regulated interstate access charges costs caused by the LECs' nonregulated billing and collection functions. By shifting some costs from interstate access services to the nonregulated billing and collection category, we would move interstate access rates closer to cost. The NPRM, however, may not have provided sufficient notice to interested parties that we would change in the allocation of LEC interstate costs between regulated interstate services and nonregulated billing and collection activities. We therefore seek comment on this issue in Section VII.B below.

V. ACCESS REFORM FOR INCUMBENT RATE-OF-RETURN LOCAL EXCHANGE CARRIERS

A. Background

329. In the NPRM we concluded that, with limited exceptions, the scope of this proceeding should be limited to incumbent price cap LECs because these carriers face the potential of significant competition in the interstate exchange access market due to the new duties and obligations imposed upon them by the 1996 Act.[470] We proposed limited exceptions that would subject all incumbent LECs to the rules addressing allocation of universal service support to the interstate revenue requirement, discussed in Section VI.D, below, and to the reforms to the transport rate structure, including the TIC, discussed in sections III.D., above. We invited comment on these tentative conclusions on the scope of this proceeding. We also sought comment on whether we should apply our proposed changes to the common line rate structure to rate-of-return incumbent LECs and whether we should update Part 69 access rules in light of various developments. We further invited comment on the effect of these proposals and tentative conclusions on small business entities, including

[469] 47 C.F.R. § 69.307(c).

[470] NPRM at ¶¶ 50-52.

small incumbent LECs and new entrants.[471] We also noted that we would address access reform for rate-of-return carriers in a separate proceeding in 1997.[472]

B. Discussion

330. We conclude that, with the limited exceptions discussed in Sections III.D and VI.D, the scope of this proceeding should be limited to price cap incumbent LECs.[473] Price cap regulation governs almost 91 percent of interstate access charge revenues[474] and more than 92 percent of total incumbent LEC access lines.[475] Currently, all ten of the incumbent LECs with more than two million access lines and 13 of the 17 non-NECA incumbent LECS with more than 50,000 access lines are subject to price cap regulation.[476] Therefore, even though this proceeding applies only to price cap incumbent LECs, it will nonetheless affect the vast majority of all access lines and interstate access revenues.

331. Small and rural LECs will most likely not experience competition as fast as incumbent price cap LECs. We do not expect small and rural LECs generally to face significant competition in the immediate future because, for the most part, the high cost/ low-margin areas served by these LECs are unlikely to be the immediate targets of new entrants or competitors. Moreover, as we noted in the NPRM, all non-price cap incumbent LECs may be exempt from, or eligible for a modification or suspension of, the interconnection and unbundling requirements of the 1996 Act.[477] By contrast, all incumbent LECs that are ineligible for section 251(f) exemption, suspensions, or modifications are incumbent price cap

[471] NPRM at ¶ 53.

[472] NPRM at ¶ 52.

[473] These incumbent LECs are the seven Regional Bell Operating Companies (Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Bell, SBC, US West), Citizens, Frontier, GTE, Aliant (formerly Lincoln), SNET, and United/Central.

[474] Universal Service Fund Data Collection, CC Docket No. 80-286, Universal Service Fund 1996 Submission of 1995 Study Results by NECA, Oct. 1, 1996.

[475] Data based on LECs' 1995 and 1996 Annual Access Tariffs filed with the Commission.

[476] Data based on LECs' 1995 and 1996 Annual Access Tariffs filed with the Commission.

[477] For example, section 251(f)(1) exempts rural telephone companies from the requirements of section 251(c)(2) until the rural telephone company has received a bona fide request for interconnection, services, or network elements, and the state commission determines that the exemption should be terminated. In addition, section 251(f)(2) permits LECs with fewer than two percent of the nation's subscriber lines to petition a state commission for a suspension or modification of any requirements of sections 251(b) and (c).

LECs.[478] Because the latter incumbent LECs must fulfill the section 251(b) and (c) duties to provide interconnection and unbundled elements to new entrants, they are likely to face significant competition in the interstate exchange access market before the small and mid-sized rate-of-return incumbent LECs face such competition.

332. We recognize that small and rural rate-of-return LECs face unique circumstances and that a few of these carriers may now have, or may soon receive, bona fide requests for interconnection. Although all rate-of-return carriers may not be completely insulated from competitive pressures, we are not persuaded by arguments that delaying the initiation of an access reform proceeding for these carriers until later this year will have a detrimental impact on their viability. A separate proceeding for small and rural rate-of-return LECs will provide us with the opportunity to conduct a comprehensive review of the circumstances and issues unique to these carriers.

333. We do not agree that Citizens Utilities should be exempt from some of the rules we adopt in this order for price cap companies. The decisions we reach here accommodate many of the concerns that Citizens Utilities, as well as a number of other price cap LECs that serve rural areas, voices in its pleadings. Although Citizens Utilities arguably may face different circumstances than other price cap LECs that serve larger urban and suburban populations, Citizens has indicated, by electing price cap regulation, that it believes it can achieve a higher rate of productivity than smaller rate-of-return LECs and that price cap regulation is more beneficial to it than rate-of-return regulation. Citizens Utilities has not demonstrated that the modifications we are adopting in this proceeding would necessarily affect it differently than other price cap LECs. If Citizens Utilities believes that it cannot remain financially viable as a price cap carrier under the revised access charge regime, it may petition for a waiver of the rule that makes its decision to elect price cap regulation irreversible.[479]

334. We reject Centennial's suggestion that we adopt access reform modifications for *all* incumbent LECs but then grant waivers for small, rural LECs whose special circumstances warrant different accommodations. For the most part, rate-of-return LECs face a common set of complex issues, different than those faced by price cap LECs, that are better addressed in a separate proceeding. In that proceeding, we will address any differences that may exist between large and small rate-of-return carriers.

335. We therefore limit application of the rules we adopt in this proceeding to the

[478] *See, e.g.*, USTA Holding Company Report 1996.

[479] In the *LEC Price Cap Order*, the Commission stated that a LEC's decision to elect price cap regulation is irrevocable. Policy and Rules concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6819 (1990).

incumbent price cap LECs, with limited exceptions. Because rate-of-return LECs will collect revenues from the new universal service support mechanisms, we address allocation of universal service support to the interstate revenue requirement for all incumbent LECs in Section VI.D. In addition, because rate-of-return incumbent LECs' transport rates were subject to the rules that were remanded by the court in *CompTel v. FCC*,[480] the changes to the TIC that we adopt in Section III.D. pursuant to the court's remand, except for changes that require reallocation of costs to newly-created rate elements, will also apply to rate-of-return incumbent LECs. Finally, in order to prevent double recovery of the costs associated with providing access services to new entrants through the sale of unbundled network elements, we conclude in Section VI.A, below, that our exclusion of unbundled network elements from Part 69 access charges applies to all incumbent LECs.

VI. OTHER ISSUES

A. Applicability of Part 69 to Unbundled Elements

1. Background

336. In the NPRM, we requested comment regarding the potential application of Part 69 access charges to unbundled network elements purchased by carriers to provide local exchange services or exchange access services.[481] We tentatively concluded that unbundled network elements should be excluded from such access charges. We noted that the 1996 Act allows telecommunications carriers to purchase access to unbundled network elements and to use those elements to provide all telecommunications services, including originating and terminating access of interstate calls.[482] We further noted that the 1996 Act requires purchasing carriers to pay cost-based rates to incumbent LECs to compensate them for use of the unbundled network elements.[483] Accordingly, we tentatively concluded that the requesting carrier paying cost-based rates to the incumbent LEC would have already compensated the incumbent LEC for the ability to deploy unbundled network elements to provide originating and terminating access.[484]

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480 *CompTel v. FCC,* 87 F.3d 522.

481 NPRM at ¶ 54.

482 *Id.*

483 *Id.*

484 *Id.*

2. Discussion

337. We will adhere to our tentative conclusion to exclude unbundled network elements from Part 69 access charges. This conclusion applies to all incumbent LECs.[485] As we noted in the *Local Competition Order*, payment of cost-based rates represents full compensation to the incumbent LEC for use of the network elements that carriers purchase.[486] We further noted that sections 251(c)(3) and 252(d)(1), the statutory provisions establishing the unbundling obligation and the determination of network element charges, do not compel telecommunications carriers using unbundled network elements to pay access charges.[487] Moreover, these provisions do not restrict the ability of carriers to use network elements to provide originating and terminating access.[488] Allowing incumbent LECs to recover access charges in addition to the reasonable cost of such facilities would constitute double recovery because the ability to provide access services is already included in the cost of the access facilities themselves. Excluding access charges from unbundled elements ensures that unbundled elements can be used to provide services at competitive levels, promoting the underlying purpose of the 1996 Act.[489] If incumbent LECs added access charges to the sale of unbundled elements, the added cost to competitive LECs would impair, if not foreclose, their ability to offer competitive access services.[490] The availability of access services at competitive levels is vital to the general approach we adopt in this Order, which relies on the growth of competition, including from competitors using unbundled network elements, to move overall access rate levels toward forward-looking economic cost.[491] In addition, we

[485] Although our rule applies to all incumbent LECs, we note that small LECs (those with fewer than two percent of the nation's subscriber lines) may petition the appropriate state commission for a suspension or modification of the unbundling requirements of the 1996 Act. 47 U.S.C. § 251(f)(2). In addition, a rural telephone company is exempt from the obligation to provide access to unbundled network elements until it has received a bona find request for unbundled elements. 47 U.S.C. § 251(f)(1). *See also, Local Competition Order*, 11 FCC Rcd at 1611.

[486] 11 FCC Rcd at 15864.

[487] *Id.*

[488] *Id.*

[489] *See* 11 FCC Rcd at 15682.

[490] There would be serious questions about the wisdom of a market-based approach to access reform as advocated by some incumbent LECs, *see, e.g.*, Ameritech Comments at 38; Cincinnati Bell Comments at 13, if incumbent LECs could impose access charges on the use of unbundled network elements.

[491] Were we to allow the assessment of access charges by incumbent LECs for access services provided by carriers over unbundled network elements, we would be compelled to take a more prescriptive approach to the rate level issue.

note that excluding unbundled network elements from access charges benefits small entities seeking to enter the local service market by ensuring that they can acquire unbundled elements at competitive prices.

338. We disagree with suggestions offered by some commenters that access charges should be imposed on unbundled elements because cost-based rates for such elements would not recover universal service support subsidies built into the access charge regime.[492] Although our plan to implement comprehensive universal service reform is not fully implemented, we believe excluding access charges from the sale of unbundled elements will not dramatically affect the ability of price cap LECs to fulfill their universal service obligations. First, competitors using unbundled network elements to provide interstate services will contribute to universal service requirements pursuant to section 254. Carriers receive no exemption from their obligation to contribute to universal service by using unbundled network elements. Second, rate structure modifications adopted in this Order -- including reallocation of TIC costs, adoption of a mechanism to phase out the TIC, and raising multi-line SLCs -- should reduce the impact on price cap LECs of excluding the recovery of TIC costs in the sale of unbundled network elements. Third, if unbundled network element prices are geographically deaveraged, LECs will receive higher prices when they sell unbundled network elements that embody higher costs. Fourth, because the difference between the level of access charges and the forward-looking economic costs of network elements may include more than universal service support, imposing access charges on the sale of unbundled network elements could recover from market entrants substantially more than amounts used to support universal service. Accordingly, we are not persuaded by suggestions that the universal service obligations of price cap LECs compel the imposition of access charges on the purchase of unbundled network elements by requesting carriers.

339. Although, in the *Local Competition Order*, we allowed application of certain non-cost-based access charges (the CCLC and a portion of the TIC) to unbundled elements, we limited the duration of such application to a transition period ending June 30, 1997 even if access and universal service reform were not completed by the end of the transition period.[493] The transition period was limited in order to minimize the burden on competitive local service providers seeking to use unbundled network elements to offer the competitive services that the 1996 Act sought to promote. The interim application of certain access charges was also limited to non-cost-based charges because such charges, unlike facilities-based charges, were more likely to include subsidies for universal service. All facilities-based charges were completely excluded from unbundled network elements to prevent double recovery by incumbent LECs of the costs of these facilities when they are purchased by competitive carriers.

[492] PacTel Comments at 55-57. *See also* GVNW Comments at 5.

[493] 11 FCC Rcd at 15866.

340. We are also unpersuaded by suggestions that access charges should be imposed on unbundled elements because provision of competitive service by rebundling the same network elements used by the incumbent LEC to provide access is equivalent to resale of a retail service.[494] First, in the *Local Competition Order*, we recognized major differences between competition through the use of unbundled network elements and competition through resale of an existing retail service offered by an incumbent LEC. We explained, for example, that an entrant relying on unbundled elements rather than resale has the flexibility to offer all telecommunications services made possible by using network elements but also assumes the risk that end users will not generate sufficient demand to justify the investment. The entrant using a resale strategy, however, is limited to offering the retail service itself without the attendant investment risk.[495] Thus, we reject the notion that the rebundling of network elements is equivalent to resale. Second, although we concluded in the *Local Competition Order* that IXCs must continue to pay access charges to incumbent LECs for access services when the end user is served by a competitive carrier reselling the incumbent LEC's retail services, our conclusion was based on the resale provisions of the 1996 Act which limit resale to retail services offered to subscribers or other customers who are not telecommunications carriers.[496] The resale provision does not apply to non-retail services, including access services, that may be offered using the same facilities.[497] Unlike the provision of local exchange services, access services are not services that LECs provide directly to end users on a retail basis. To impose access charges on the sale of unbundled elements would contravene the terms of the resale provision by effectively treating exchange access as a service provided on a retail basis.

B. Treatment of Interstate Information Services

1. Background

341. In the 1983 *Access Charge Reconsideration Order*, the Commission decided that, although information service providers[498] (ISPs) may use incumbent LEC facilities to originate

[494] BellSouth Comments at 13; PacTel Reply at 8-10.

[495] 11 FCC Rcd at 15667-68.

[496] 47 U.S.C. § 251(c)(4)(A).

[497] 11 FCC Rcd at 15982-83.

[498] The term "enhanced services," which includes access to the Internet and other interactive computer networks, as well as telemessaging, alarm monitoring, and other services, appears to be quite similar to the term "information services" in the 1996 Act. "Enhanced services" are defined in § 64.702(a) of our rules: "For the purposes of this subpart, the term *enhanced services* shall refer to services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act

and terminate interstate calls, ISPs should not be required to pay interstate access charges.[499] In recent years, usage of interstate information services, and in particular the Internet and other interactive computer networks, has increased significantly.[500] Although the United States has the greatest amount of Internet users and Internet traffic, more than 175 countries are now connected to the Internet.[501] As usage continues to grow, information services may have an increasingly significant effect on the public switched network.

342. As a result of the decisions the Commission made in the *Access Charge Reconsideration Order*, ISPs may purchase services from incumbent LECs under the same intrastate tariffs available to end users. ISPs may pay business line rates and the appropriate subscriber line charge, rather than interstate access rates, even for calls that appear to traverse state boundaries.[502] The business line rates are significantly lower than the equivalent interstate access charges, given the ISPs' high volumes of usage.[503] ISPs typically pay incumbent LECs a flat monthly rate for their connections regardless of the amount of usage they generate, because business line rates typically include usage charges only for outgoing traffic.

343. In the *NPRM*, we tentatively concluded that ISPs should not be required to pay interstate access charges as currently constituted. We explained that the existing access charge system includes non-cost-based rates and inefficient rate structures. We stated that there is no

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on the format, content, code, protocol, or similar aspects of the subscriber's transmitted information; provide the subscriber additional different, or restructured information; or involve subscriber interaction with stored information." The 1996 Act defines "information services" as offering the capability for "generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications." 47 U.S.C. § 153(20). For purposes of this order, providers of enhanced services and providers of information services are referred to as ISPs.

[499] MTS and WATS Market Structure, Memorandum Opinion and Order, Docket No. 78-72, 97 FCC 2d 682, 711-22 (*Access Charge Reconsideration Order*). *See also* Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Order, 3 FCC Rcd 2631 (1988) (*ESP Exemption Order*).

[500] The number of U. S. households with Internet access more than doubled over the past year, and approximately 38.7 million Americans over the age of 18 have accessed the Internet at least once. Jared Sandberg, "U.S. Households with Internet Access Doubled to 14.7 Million in Past Year, *Wall Street Journal*, October 21, 1996, at B11.

[501] Network Wizards Internet Domain Survey, January 1997, available on the World Wide Web at <http://www.nw.com/zoneWWW/top.html>.

[502] *ESP Exemption Order*, 3 FCC Rcd at 2631 nn.8, 53. To maximize the number of subscribers that can reach them through a local call, most ISPs have deployed points of presence.

[503] CIEA Comments at 5-6.

reason to extend such a system to an additional class of customers, especially considering the potentially detrimental effects on the growth of the still-evolving information services industry. We explained that ISPs should not be subjected to an interstate regulatory system designed for circuit-switched interexchange voice telephony solely because ISPs use incumbent LEC networks to receive calls from their customers.[504] We solicited comment on the narrow issue of whether to permit incumbent LECs to assess interstate access charges on ISPs.[505] In the companion *Notice of Inquiry (NOI)*, we sought comment on broader issues concerning the development of information services and Internet access.[506]

2. Discussion

344. We conclude that the existing pricing structure for ISPs should remain in place, and incumbent LECs will not be permitted to assess interstate per-minute access charges on ISPs. We think it possible that had access rates applied to ISPs over the last 14 years, the pace of development of the Internet and other services may not have been so rapid. Maintaining the existing pricing structure for these services avoids disrupting the still-evolving information services industry[507] and advances the goals of the 1996 Act to "preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation."[508]

345. We decide here that ISPs should not be subject to interstate access charges. The access charge system contains non-cost-based rates and inefficient rate structures, and this Order goes only part of the way to remove rate inefficiencies. Moreover, given the evolution in ISP technologies and markets since we first established access charges in the early 1980s, it is not clear that ISPs use the public switched network in a manner analogous to IXCs. Commercial Internet access, for example, did not even exist when access charges were established. As commenters point out, many of the characteristics of ISP traffic (such as large numbers of incoming calls to Internet service providers) may be shared by other classes of business customers.

346. We also are not convinced that the nonassessment of access charges results in

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[504] NPRM at para 288.

[505] *Id.*

[506] *See In the Matter of* Usage of the Public Switched Network by Information Service and Internet Access Providers, CC Docket No. 96-263, Notice of Inquiry, FCC 96-488 (rel. December 24, 1996) (*NOI*).

[507] *See, e.g.*, CompuServe/Prodigy Comments at 11; Information Industry Association Comments at 4; Minnesota Internet Services Trade Association Reply at 1.

[508] 47 U.S.C. § 230(b)(2).

ISPs imposing uncompensated costs on incumbent LECs. ISPs do pay for their connections to incumbent LEC networks by purchasing services under state tariffs. Incumbent LECs also receive incremental revenue from Internet usage through higher demand for second lines by consumers, usage of dedicated data lines by ISPs, and subscriptions to incumbent LEC Internet access services. To the extent that some intrastate rate structures fail to compensate incumbent LECs adequately for providing service to customers with high volumes of incoming calls, incumbent LECs may address their concerns to state regulators.

347. Finally, we do not believe that incumbent LEC allegations about network congestion warrant imposition of interstate access charges on ISPs.[509] The Network Reliability and Interoperability Council has not identified any service outages above its reporting threshold attributable to Internet usage, and even incumbent LEC commenters acknowledge that they can respond to instances of congestion to maintain service quality standards. Internet access does generate different usage patterns and longer call holding times than average voice usage. However, the extent to which this usage creates congestion depends on the ways in which incumbent LECs provision their networks, and ISPs use those networks. Incumbent LECs and ISPs agree that technologies exist to reduce or eliminate whatever congestion exists; they disagree on what pricing structure would provide incentives for deployment of the most efficient technologies.[510] The public interest would best be served by policies that foster such technological evolution of the network. The access charge system was designed for basic voice telephony provided over a circuit-switched network, and even when stripped of its current inefficiencies it may not be the most appropriate pricing structure for Internet access and other information services.

348. Thus, in our review of the record filed in response to the *NOI,* we will consider solutions to network congestion arguments other than the incumbent LECs' recommendation that we apply access charges to ISPs' use of circuit-switched network technology. We intend rather to focus on new approaches to encourage the efficient offering of services based on new network configurations and technologies, resulting in more innovative and dynamic services than exist today. In the *NOI,* we will address a range of fundamental issues about the Internet and other information services, including ISP usage of the public switched network.[511] The *NOI* will give us an opportunity to consider the implications of information services more broadly, and to craft proposals for a subsequent NPRM that are sensitive to the complex economic, technical, and legal questions raised in this area. We therefore conclude

[509] *See, e.g.,* USTA Comments at 81-82.

[510] SWBT Comments at 20; PacTel Reply at 26; Internet Access Coalition Reply at 11-12; America On-Line Reply at 7-9.

[511] In particular, we requested data about alleged network congestion, rates paid by ISPs today, alternative network access technologies, and additional services desired by ISPs. *NOI* at ¶¶ 313-317.

that ISPs should remain classified as end users for purposes of the access charge system.

C. Terminating Access

349. In the NPRM, we requested comment regarding the regulation of terminating access. We noted that, unlike originating access, the choice of an access provider for terminating access is made by the recipient of the call. The call recipient generally does not pay for the call and, therefore, is not likely to be concerned about the rates charged for terminating access. We suggested that neither the originating caller nor its long-distance service provider can exert substantial influence over the called party's choice of terminating access provider.[512] Thus, even if competitive pressures develop at the originating end as new entrants offer alternatives, the terminating end of a long-distance call may remain a bottleneck, controlled by the LEC providing access for a particular customer.[513] We also recognized, however, that excessive terminating access charges could furnish an incentive for IXCs to enter the access market in order to avoid paying excessive terminating access charges.[514]

1. Price Cap Incumbent LECs

a. Background

350. We requested comment on various alternative special methods for regulating the terminating access rates of price cap LECs. For instance, we sought comment on whether to establish a ceiling on the terminating access rates of price cap LECs equal to the forward-looking economic cost of providing the service. We suggested alternative methods for measuring forward-looking economic cost, including reference to prices in reciprocal compensation arrangements for the transport and termination charges of telecommunications under sections 251(b)(5) and 252(d)(2) or a requirement that terminating rates be based on a TSLRIC study or other acceptable forward-looking cost-based model.[515]

b. Discussion

351. We believe that new entrants, by purchasing unbundled network elements or providing facilities-based competition, will eventually exert downward pressure on originating

[512] NPRM at ¶ 271.

[513] *Id.*

[514] *Id.* at ¶ 272.

[515] NPRM at ¶ 274.

access rates assessed by incumbent LECs. We agree that excessive terminating access rates could encourage long-distance companies to avoid the payment of such charges by seeking to become the local exchange and exchange access provider for end user customers. These market developments, however, would not fully address the concerns expressed in the NPRM and reflected in comments with respect to the ability of incumbent LECs to charge unreasonable rates for terminating access.

352. We are also not convinced that a significant competitive impact would result from changes in calling patterns between pairs of callers. Commenters have not described any realistic way that users, by changing their calling patterns, could experience savings attributable to differing levels of terminating access charges paid by IXCs.[516] Although one commenter points to high termination charges in foreign countries as affecting the market for overseas calls originating in the United States,[517] such results are less likely to occur for domestic calls, which are much less expensive than international calls and are subject to geographic rate averaging and rate integration requirements.[518] Thus, we are reluctant to base our approach on the expectation that a significant proportion of callers will implement such a strategy.

353. Accordingly, we are establishing regulatory requirements that will address the potential that incumbent LECs could charge unreasonable rates for terminating access. Specifically, we are adopting rules in this Order that, for price cap LECs, will limit recovery of TIC and common line costs from terminating access rates for a limited period, and then eliminate any recovery of common line and TIC costs from terminating access. Under this approach, beginning January 1, 1998, price cap LECs will recover common line and residual TIC revenues through a new flat charge, subject to a ceiling. Remaining common line and residual TIC revenues will then be first recovered through originating access rates, subject to a ceiling. Any remaining common line and residual TIC revenues may then be recovered through terminating rates. As the caps on SLCs applicable to non-primary residential lines and the PICC are raised, none of these residual revenues will be recovered through terminating access charges. When the increased SLCs and PICCs are fully implemented, recovery of these costs will be more susceptible to competitive forces because IXCs could seek to influence the end user's choice of its provider of local service, and the end user's choice of service provider will determine whether the incumbent LEC is able to recover these

[516] We question whether switching carriers would have an immediate impact on the overall cost of long-distance calls between discrete pairs of callers. A local access provider's terminating access charges are spread across an IXC's customer base. As a practical matter, alterations in calling behavior, unless done on a massive scale across the IXC's customer base, are not likely to have an immediate or predictable impact on the bills of two callers seeking to reduce the cost of their long-distance calls to each other.

[517] TCI Comments, Attachment A at 4.

[518] NPRM at n. 357.

costs from the end user.

354. In addition, pending full recovery of all common line and residual TIC costs in flat rate SLCs and PICCs, this approach will put downward pressure on terminating access rates by lowering the overall service revenues derived from terminating access charges. Because competitive pressure is more likely to develop on the originating end of a long-distance call, we can rely to a greater extent on competitive forces to ensure just and reasonable rates under this approach by moving recovery of certain revenues from terminating access to originating access. By stripping terminating access rates of CCL and residual TIC charges and, pending full implementation of the new flat charges, placing more of the burden of TIC recovery on originating access rates, we reduce potential excesses in terminating access charges while exposing the CCL and residual TIC recovery to competitive pressures in the originating access market.

355. The NPRM described proposals linking terminating rates to originating rate levels or shifting costs from terminating to originating access charges.[519] Some commenters support limiting price cap LEC terminating access rates to the level of the LEC originating access rates.[520] If originating access charges are lowered because of competition, the ceiling on terminating access rates would be lowered as well, placing downward pressure on terminating rates. This approach, however, would not substantially affect terminating access rates where originating access rates have not responded to competitive inroads. Moreover, linking an incumbent LEC's terminating access rate to its own originating rate could reduce the incumbent LEC's incentive to lower its originating access rates. Thus, we decline to adopt this method of regulating terminating access rates.

356. The NPRM requested comment on the possibility of eliminating all charges for terminating access by shifting the burden of recovering all costs currently recovered in terminating access rates to originating access charges.[521] We decline to adopt this approach because a complete shift of terminating access costs to originating access conflicts with one of the basic objectives of this proceeding -- to ensure that charges for access services reflect the manner in which the costs of providing those services are incurred. Switching costs, for example, should continue to be recovered in part from terminating access charges because those costs are traffic sensitive and are related to the volumes of both originating and terminating traffic. Moreover, we emphasize that, as discussed in Section III.A, the rate structure we are adopting, which will replace per-minute recovery of the CCL charge and the TIC with flat rate charges, helps to achieve our goal of ensuring that charges for access

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[519] NPRM at ¶ 276.

[520] BA/NYNEX Comments at 42; Ohio Commission Comments at 12.

[521] NPRM at ¶ 276.

services reflect the manner in which costs are incurred. Our requirement that incumbent LECs recover a greater portion of common line and TIC costs in originating access rates pending full implementation of flat-rated charges will address concerns about the reasonableness of terminating access charges while providing price cap LECs sufficient latitude to recover the reasonable costs of deploying their facilities to provide terminating access services.

357. The NPRM also discussed the alternative of requiring price cap LECs to establish end user charges for terminating access. This approach would place direct responsibility for the cost of terminating access on the recipient of terminating access services and would expose terminating access to competitive pressures. We noted that wireless companies already charge called parties for receiving calls and requested comment on how we might implement a system of end user charges in the context of access reform and whether its implementation would increase the number of uncompleted calls due to a reluctance by called parties to accept the charges.[522] We agree with commenters that such a change could prove disruptive to consumers of wireline services.[523] After review of the record, which produced few, if any, advocates of such an approach, we conclude that we should not mandate at this time this change in current pricing practices for wireline service.

2. Non-Incumbent LECs

a. Background

358. In the NPRM, we requested comment about whether to impose ceilings on the terminating access rates of non-incumbent LECs.[524] We stated in the NPRM that our policy since the *Competitive Carrier Proceeding*,[525] has consistently been that a carrier is non-dominant unless the Commission makes or has made a finding that it is dominant.[526] We noted that, since the *Competitive Carrier Proceeding*, new entrants into the exchange access market have been presumptively classified as non-dominant because they have not been shown

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[522] NPRM at ¶ 275.

[523] Ameritech Comments at 54; LCI Comments at 19; California Commission Comments at 17-18.

[524] NPRM at ¶ 280.

[525] In the *Competitive Carrier Proceeding*, we established a comprehensive framework for determining whether carriers are dominant or non-dominant, classified then existing classes of carriers as either dominant or non-dominant, and promulgated general definitions providing that a carrier will be non-dominant in the absence of a Commission finding of market power. *Competitive Carrier First Report and Order*, 85 FCC 2d at 51 (promulgating 47 C.F.R. § 61.15(A)(2)).

[526] NPRM at ¶ 277.

to exercise significant market power in their service areas.[527] At the same time, we stated that competitive LECs may possess market power over IXCs needing to terminate calls because the LEC controlling the terminating local loop is the only access provider available to the IXC seeking to terminate a long-distance call on that particular loop.[528] We solicited comment on several alternatives, including whether we should use incumbent LEC terminating access rates as a benchmark to determine the reasonableness of competitive LEC terminating rates. We invited commenters to offer other approaches including, for example, whether we should establish a presumption of reasonableness if the competitive LEC's terminating access rate is no higher than the incumbent LEC's rate in the same geographic market.[529]

b. Discussion

359. We recently noted that the test in deciding whether to apply dominant carrier regulation to a class of carriers is whether those carriers have market power.[530] As we discussed in the *Dominant/Nondominant Order*, in determining whether a firm possesses market power, the Commission has previously focused on certain well-established market features, including market share, supply and demand substitutability, the cost structure, size or resources of the firm, and control of bottleneck facilities.[531] Competitive LECs currently have

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[527] *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979) (*Competitive Carrier NPRM*); First Report and Order, 85 FCC 2d 1 (1980) (*First Report and Order*); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981) (*Competitive Carrier Further NPRM*); Second Further Notice of Proposed Rulemaking, FCC 82-187. 47 Fed. Reg. 17,308 (1982); Second Report and Order, 91 FCC 2d 59 (1982) (*Second Report and Order*); Order on Reconsideration, 93 FCC 2d 54 (1983); Third Further Notice of Proposed Rulemaking, 48 Fed. Reg. 28,292 (1983); Third Report and Order, 48 Fed. Reg. 46,791 (1983); Fourth Report and Order, 95 FCC 2d 554 (1983) (*Fourth Report and Order*), *vacated, AT&T Co. v. FCC*, 978 F.2d 727 (D.C. Cir. 1992), *cert. denied, MCI Telecommunications Corp. v. AT&T Co.*, 509 U.S. 913 (1993); Fourth Further Notice of Proposed Rulemaking, 96 FCC 2d 922 (1984); Fifth Report and Order, 98 FCC 2d 1191 (1984) (Fifth Report and Order); Sixth Report and Order, 99 FCC 2d 1020 (1985) (*Sixth Report and Order*), *vacated, MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186 (D.C. Cir. 1985) (collectively referred to as the *Competitive Carrier proceeding*).

[528] *Id.* at ¶ 279.

[529] *Id.* at ¶ 280.

[530] *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket Nos. 96-149 and 96-61, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, FCC 97-142 at ¶ 12 (rel. April 18, 1997) *(Dominant/Non-Dominant Order)*.

[531] *Dominant/Non-Dominant Order* at ¶ 93. *See also Implementation of Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area,* Notice of Proposed Rulemaking, FCC

a relatively small market share in the provision of local exchange and exchange access service. Nonetheless, at first blush, there is a concern that a competitive LEC may have market power over an IXC that needs to terminate a long-distance call to a customer of that particular competitive LEC. Therefore, we sought comment on whether and to what extent we should regulate the terminating access charges of competitive LECs.

360. We conclude, based on the record before us, that non-incumbent LECs should be treated as nondominant in the provision of terminating access. Although an IXC must use the competitive LEC serving an end user to terminate a call, the record does not indicate that competitive LECs have previously charged excessive terminating access rates. Nor have commenters provided evidence demonstrating that competitive LECs are, in fact, charging excessive terminating rates. Indeed, the record suggests that the terminating rates of competitive LECs are equal to or below the tariffed rates of incumbent LECs.[532] In addition, the record does not show that competitive LECs distinguish between originating and terminating access in their offers of service. Therefore, it does not appear that competitive LECs have structured their service offerings in ways designed to exercise any market power over terminating access. Accordingly, the concerns expressed in the NPRM about the ability of competitive LECs to exercise market power in the provision of terminating access are not substantiated in the record.

361. Further, as competitive LECs, which have a small share of the interstate access market, attempt to expand their market presence, the rates of incumbent LECs or other potential competitors will constrain the terminating access rates of competitive LECs.[533] Specifically, competitive LECs compete with incumbent LECs whose rates are regulated. The record indicates that long-distance carriers have established relationships with incumbent LECs for the provision of access services, and new market entrants are not likely to risk damaging their developing relationships with IXCs by charging unreasonable terminating access rates.[534] This is especially true with respect to competitive access providers seeking to maintain or expand their access transport, special access, or other services apart from switched access.[535]

362. In addition, we believe that overcharges for terminating access could encourage

No. 96-308, CC Docket No. 94-149 at ¶ 133 (rel. July 18, 1996).

[532] Spectranet Comments at 7; TCI Comments, Attachment A at 6.

[533] ALTS Comments at 29; American Communications Services Reply at 21; ICG Telecom Group Reply at 23.

[534] *See* WinStar Comments at 5-6; TCI Comments, Attachment A at 9; Cox Communications Reply at 4-5.

[535] ALTS Comments, Attachment B at 14.

access customers to take competitive steps to avoid paying unreasonable terminating access charges. If, for example, a competitive LEC consistently overcharged an IXC for terminating access, the IXC would have an incentive to enter a marketing alliance with another competitive LEC in the same market or in other geographic markets where the overcharging competitive LEC seeks to expand. Although high terminating access charges may not create a *disincentive* for the call recipient to retain its local carrier (because the call recipient does not pay the long distance charge), the call recipient may nevertheless respond to *incentives* offered by an IXC with an economic interest in encouraging the end user to switch to another local carrier. Such an approach could have particular impact when the IXC has significant brand recognition among consumers. Moreover, as noted in the NPRM, excessive terminating access charges could encourage IXCs to enter the access market in an effort to win the local customer.[536] We believe that the possibility of competitive responses by IXCs will have a constraining effect on non-incumbent LEC pricing.

363. Thus, we will not adopt at this time any regulations governing the provision of terminating access provided by competitive LECs.[537] Because competitive LECs have not charged unreasonable terminating access rates, and because they are not likely to do so in the future, competitive LECs do not appear to possess market power. Thus, the imposition of regulatory requirements with respect to competitive LEC terminating access is unnecessary. We similarly find no reason to adopt a presumption of reasonableness where a competitive LEC's terminating access rates are less than its rates for originating access or less than the incumbent LEC's terminating access rates. Instead, if we need to examine the reasonableness of competitive LEC terminating access rates in an individual instance, we can do so taking into account all relevant factors including relationships to other rates. Thus, if an access provider's service offerings violate section 201 or Section 202 of the Act, we can address any issue of unlawful rates through the exercise of our authority to investigate and adjudicate complaints under section 208.[538] On the basis of the current record, we conclude that reliance on the complaint process will be sufficient to assure that non-incumbent LEC rates are reasonable. We emphasize that we will not hesitate to use our authority under section 208 to take corrective action where appropriate.

364. We will be sensitive to indications that the terminating access rates of competitive LECs are unreasonable. The charging of terminating access rates above originating rates in the same market, for example, may suggest the need to revisit our

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536 NPRM at ¶ 272.

537 We are examining in a separate proceeding whether tariffing of rates for access services provided by competitive LECs is necessary to assure that such rates are reasonable. *See* Petitions Requesting Forbearance of Hyperion Telecommunications, Inc. (CCB/CPD No. 96-462) and Time Warner Communications (CCB/CPD No. 96-902).

538 47 U.S.C. § 208.

regulatory approach. Similarly, terminating rates that exceed those charged by the incumbent LEC serving the same market may suggest that a competitive LEC's terminating access rates are excessive. If there is sufficient indication that competitive LECs are imposing unreasonable terminating access charges, we will revisit the issue of whether to adopt regulations governing competitive LEC rates for terminating access.

3. "Open End" Services

365. In some cases, an IXC is unable to influence the end user's choice of access provider for originating access services because the end user on the terminating end is paying for the call. For example, charges for the "open end" originating access minutes for 800 or 888 services are paid by the recipient of the call. Consequently, the Commission has treated incumbent LEC originating "open end" minutes as terminating minutes for access charge purposes.[539] The NPRM solicited comment on whether such regulatory treatment should be retained for "open end" services under which terminating access rates serve as originating access rates, and whether this approach should be extended to competitive LECs.[540]

366. We continue to believe that "open end" originating minutes should be treated as terminating minutes for access charge purposes. Although few comments were filed regarding this issue, commenters addressing this matter advocate retention of the current regulatory approach.[541] By continuing to treat "open end" originating minutes as terminating minutes for access charge purposes, we recognize that access customers have limited ability to influence the calling party's choice of access provider. Accordingly, access charges for these "open end" minutes will be governed by the requirements we adopt in this Order applicable to terminating access provided by incumbent LECs. Thus, residual common line charges and the per-minute TIC will not be recovered through "open end" originating minutes except to the extent such recovery is permitted under the rules described in Section III.A of this Order.

D. Universal Service-Related Part 69 Changes

367. In the NPRM, we recognized that, because of the role that access charges have played in funding and maintaining universal service, it is critical to implement changes in the access charge system together with complementary changes in the universal service system. In this section, we address the manner in which incumbent LECs must adjust their interstate access charges to reflect the universal service support mechanisms adopted in the *Universal Service Order*.

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[539] 47 C.F.R. § 69.105(b)(1)(iii).

[540] NPRM at ¶ 281.

[541] ACTA Comments at 24; WorldCom Comments at 93.

1. Background

368. In November 1996, pursuant to Section 254 of the Act, the Federal-State Universal Service Joint Board issued its recommendations to the Commission for reforming our system of universal service so that universal service is preserved and advanced, but in a manner that permits the local exchange and exchange access markets to move from monopoly to competition.[542] In our *Universal Service Order*, we are adopting most of the Joint Board's recommendations relating to the support of rural and high cost areas.

369. Section 254 of the Act requires that any federal universal service support provided to eligible carriers be "explicit"[543] and recovered on an "equitable and nondiscriminatory basis"[544] from all telecommunications carriers providing interstate telecommunications service. In our companion *Universal Service Order*, we agree with the Joint Board that these programs must be replaced with universal service support mechanisms that satisfy section 254.[545]

370. Currently, there are three mechanisms designed expressly to provide support for high cost and small telephone companies: the Universal Service Fund (high cost assistance fund),[546] the Dial Equipment Minutes (DEM) weighting program,[547] and Long Term Support (LTS).[548] An incumbent LEC is eligible for high cost assistance from the current Universal Service Fund if its embedded loop costs exceed 115 percent of the national average loop cost. This program is funded entirely by IXCs.[549] DEM weighting assistance is an implicit support mechanism that permits LECs with fewer than 50,000 access lines to apportion a greater proportion of these local switching costs to the interstate jurisdiction than larger LECs may allocate. Finally, the existing LTS program supports carriers with higher-than average subscriber line costs by providing carriers that are members of the NECA pool with enough

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[542] *Joint Board Recommended Decision*, 12 FCC Rcd 87.

[543] 47 U.S.C. § 254(e).

[544] 47 U.S.C. § 254(d).

[545] *See* Section III of the *Universal Service Order*.

[546] 47 C.F.R. § 36.601 *et seq.*

[547] 47 C.F.R. § 36.125(b).

[548] 47 C.F.R. §§ 69.105, 69.502, 69.603(e), 69.612.

[549] Each IXC with at least .05 percent of presubscribed lines nationwide contributes to the fund an amount based on the number of its presubscribed lines. 47 C.F.R. § 69.116.

support to enable them to charge IXCs only a nationwide average CCL interstate access rate.[550] LTS payments reduce the access charges of smaller, rural incumbent LECs participating in the loop-cost pool by raising the access charges of non-participating incumbent LECs.

371. In the NPRM, we sought comment on whether incumbent LECs' access charges must be adjusted to reflect elimination of LTS contribution requirements and receipt of explicit universal service funds in order to prevent incumbent LECs from being compensated twice for providing universal service.[551] We proposed a downward exogenous cost adjustment for price cap incumbent LECs to reflect elimination of LTS contribution requirements and any revenues received from any new universal service support mechanisms, and sought comment on how interstate costs must also be reduced to account for explicit universal service support.[552]

2. Discussion

372. In our companion *Universal Service Order*, we conclude that a carrier will continue to receive universal service support based upon the existing LTS, high cost, DEM weighting mechanisms, until the carrier begins to receive support based upon forward-looking economic cost.[553] In the following sections, we will discuss the manner in which incumbent LECs must reduce their interstate access charges to reflect the elimination of the obligation to contribute to LTS, increase their interstate access charges to permit recovery of the new universal service obligation, and, to the extent necessary, adjust their interstate access charges to account for any additional universal service funds received under the modified universal service mechanisms.

[550] Prior to 1989 all LECs were required to participate in a pool of carrier common line costs and revenues. Beginning in April 1989, LECs were permitted to withdraw from the pool, but LECs with below average CCL charges that choose to exit the pool are required to contribute enough so that LECs remaining in the pool would be able to charge the same industry average CCL rates they would have charged if the pool were still mandatory for all LECs. *See* MTS and WATS Market Structure; Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72, 80-286, Report and Order, 2 FCC Rcd 2953 (1987).

[551] NPRM at ¶ 244.

[552] NPRM at ¶¶ 245-46.

[553] *See* Section VII.D of the *Universal Service Order*.

a. Removal of LTS Obligation from Interstate Access Rates

373. In our companion *Universal Service Order*,[554] we agree with the Joint Board that LTS payments constitute a universal service support mechanism that is inconsistent with the Act's requirement that support be collected from all providers of interstate telecommunications services on an equitable and non-discriminatory basis[555] and be available to all eligible telecommunications carriers.[556] In that order, we conclude that LTS should be removed from the interstate access charge system. We provide, instead, for recovery of comparable payments from the new federal universal service support mechanisms.[557]

374. Currently, only incumbent LECs that do not participate in the NECA CCL tariff (non-pooling incumbent LECs) make LTS payments and only incumbent LECs participating in the NECA CCL tariff receive LTS support.[558] Non-pooling incumbent LECs' contributions to the common line pool are set annually based on the total projected amount of LTS, converted to a monthly payment amount. Non-pooling incumbent LECs recover the revenue necessary for their LTS contributions through their CCL charges. We agree with commenters that argue that, to the extent we do not reduce interstate access revenues by the amount of LTS contribution currently recovered in the rates, incumbent LECs will double recover. We therefore conclude that incumbent LEC interstate access charges must be reduced to reflect elimination of the obligation to contribute to LTS.

375. Because payments from the existing LTS mechanism will cease on January 1, 1998, incumbent LECs should no longer contribute to the existing LTS fund after that date. For price cap LECs, which were requested to stop participating in the NECA Common Line tariff before coming under price cap regulation, LTS contributions were included in the common line revenue requirement when the PCI for the common line basket was established.[559] We conclude that price cap LECs must make a one-time downward exogenous adjustment to the PCI for the common line basket to account fully for the elimination of their LTS obligations. This exogenous adjustment shall be made in a manner consistent with

[554] *See* Section XII.B of the *Universal Service Order*.

[555] 47 U.S.C. § 254(d).

[556] *See* 47 U.S.C. § 254(e).

[557] *See* Sections VII and XII.B of the *Universal Service Order*.

[558] *See* 47 C.F.R. § 69.105(b)(3)-(4).

[559] *See* 47 C.F.R. §§ 69.501(a).

section 61.45 and other relevant provisions of the Commission's rules.[560]

376. Non-pooling, rate-of-return LECs recover their LTS contributions in the common line revenue requirement.[561] Because current LTS contributors will no longer be making such contributions after January 1, 1998, their CCL charges should be adjusted to account for this change. Rate-of-return LECs that formerly made LTS contributions should recompute their common line revenue requirements based on the elimination of their LTS obligations, and adjust their CCL charges accordingly.[562]

377. We note that the replacement of LTS with comparable support from the new universal service support mechanisms requires us to amend the NECA Common Line tariff rules, which establish the CCL for pooling members at the average of price cap LECs' CCL charges.[563] Under the current LTS support system, NECA annually projects the common line revenue requirement, including an 11.25 percent return on investment, for incumbent LECs that participate in the common line pool.[564] NECA then computes the total amount of LTS support needed by subtracting the amount pooling carriers will receive in CCL revenues and SLCs from the pool's projected revenue requirement, after removing pay telephone costs and revenues. Our rules currently provide that the NECA CCL tariff be set to recover the average of price cap LECs' CCL charges.[565] If we were to retain this rule, our decision eliminating LTS obligations for price cap LECs and requiring them to reduce their CCL charges accordingly would automatically reduce the CCL revenues of NECA pool members. Further, reductions would occur as price cap LECs implemented our decisions in Section III of this Order, which restructures the common line rate structure for price cap LECs to recover common line costs through flat-rated charges instead of the per-minute CCL charge. Because we have deferred consideration of access reform for non-price cap LECs[566] and did not seek comment on this issue in the NPRM, we must address this issue in a future proceeding that undertakes access reform for small, non-price cap LECs.

[560] 47 C.F.R. § 61.45.

[561] *See* 47 C.F.R. § 69.501(a).

[562] *See* 47 C.F.R. § 69.105(b)(4)(ii).

[563] *See* 47 C.F.R. § 69.105(b)(2).

[564] The actual rate of return that pooling companies earn on a monthly basis is determined by the total rate of return that the pool earns, *i.e.*, the difference between the total costs that the pooling companies submit and the total amount of revenue in the pool, as a percentage of all pooling companies' total common line investment.

[565] *See* 47 C.F.R. § 69.105(b)(2).

[566] *See* Section V.B, *supra*.

b. Recovery of New Universal Service Obligations

378. In the *Universal Service Order*, we conclude that assessment of contributions for the interstate portion of the high cost and low-income support mechanisms shall be based solely on end-user interstate revenues,[567] and that assessment of universal support for eligible schools, libraries, and rural health care providers shall be based on interstate and intrastate total end-user revenues.[568] As to the manner in which carriers may recover their contributions to the universal service fund, in our *Universal Service Order* we conclude that carriers may recover universal service contributions via interstate mechanisms.[569] In this Section, we address the manner in which incumbent price cap LECs may recover their universal service contributions. We address non-price cap LECs' recovery of universal service contributions in Section XIII.F of the *Universal Service Order*.

379. Price cap LECs may treat their contributions to the new universal service mechanisms, including high cost and low-income support and support for eligible schools, libraries, and health care, as exogenous changes to their price cap indices (PCIs).[570] Because the only interstate revenues that will serve as the basis for assessing universal service contributions in 1998 will be end-user revenues, we find that price cap LECs recovering their universal service obligation through interstate access charges must recover those contributions in the baskets for services that generate end-user interstate revenues. Because price cap LECs do not recover revenues from end users of services in all baskets, the exogenous adjustment should not be across-the-board. The baskets containing end-user interstate services are the common line, interexchange, and trunking baskets.[571] Price cap LECs electing to recover their universal service obligation through interstate access charges must therefore apply the full amount of the exogenous adjustment among these three baskets on the basis of relative size of end-user revenues. We note, however, that the tandem-switched transport, interconnection charge, and tandem switch signalling service categories[572] in the trunking basket do not recover end-user interstate revenues. In order to prevent recovery from customers of these services, the service band indices (SBI) for these service categories should not be increased to

[567] *See* Sections VII, VIII, and XIII.F of the *Universal Service Order*.

[568] *See* Sections X, XI, and XIII.F of the *Universal Service Order*.

[569] *See* Section XII of the *Universal Service Order*.

[570] *See* Section XIII.E of the *Universal Service Order*.

[571] The end-user charges assessed on services in the common line basket are recovered through the SLC; in the interexchange basket, end-user charges are recovered through per-minute toll charges; and in the trunking basket, end user charges are recovered through special access service provided directly to end users.

[572] 47 C.F.R. §§ 61.42(e)(2)(v), (vi), and (vii).

reflect the exogenous adjustment to the PCI for the trunking basket. To reflect the exogenous adjustment to the trunking basket PCI, price cap LECs should, instead, increase the SBIs for the remaining service categories in the trunking basket[573] based on the relative end-user interstate revenues generated in each service category.

380. In 1999, the percentage of price cap LECs' revenues that will be assessed for universal service support may increase as a result of the anticipated increases in high cost, low-income support and support for schools, libraries, and health care in 1999. Price cap LECs shall therefore perform an upward exogenous adjustment to the PCIs for the common line, interexchange, and trunking baskets in the same manner as the exogenous adjustment performed in 1998, to reflect any change in the assessment rate in 1999.

c. Adjustments to Interstate Access Charges to Reflect Additional Support from the Modified Universal Service Mechanisms

381. In our *Universal Service Order*, we conclude that the federal universal service mechanism should support 25 percent of the difference between the forward-looking economic cost of serving the customer and the appropriate revenue benchmark.[574] We further conclude in that order that 25 percent approximates the portion of the cost of providing the supported network facilities that would be assigned to the interstate jurisdiction, and that, by funding these interstate costs, we will ensure that federal implicit universal service support is made explicit. Consistent with our decision in the *Universal Service Order* to fund only interstate costs through the federal universal service fund, we direct incumbent LECs to use any universal service support received from the new universal service mechanisms to reduce or satisfy the interstate revenue requirement otherwise collected through interstate access charges.

382. *Non-Rural Carriers.* In our *Universal Service Order*, we conclude that, until a forward-looking economic cost methodology takes effect on January 1, 1999, non-rural carriers will continue to receive high cost assistance and LTS amounts based on the existing universal service mechanisms.[575] As there will be no change until January 1, 1999 to the support non-rural incumbent LECs currently receive as high cost and LTS support, we conclude that it is not necessary at this time to determine the manner in which non-rural carriers should adjust their interstate access charges to reflect a difference in universal service

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[573] The four remaining service categories in the trunking basket are as follows: (1) voice grade entrance facilities, voice grade direct-trunked transport, voice grade dedicated signalling transport, voice grade special access, WATS special access, metallic special access, and telegraph special access services; (2) audio and video service; (3) high capacity flat-rated transport, high capacity special access, and DDS services; and (4) wideband data and wideband analog services. *See* 47 C.F.R. §§ 61.42(e)(2)(i), (ii), (iii), (iv).

[574] *See* Section VII.C.6 of the *Universal Service Order*.

[575] *See* Section VII.D.1 of the *Universal Service Order*.

support. We will address this issue prior to the January 1, 1999, effective date of the forward-looking cost mechanisms for non-rural carriers.

383. *Rural Carriers.* In our *Universal Service Order*, we conclude that rural carriers, as defined in section 153(37) of the Act,[576] shall continue to receive support based on embedded costs for at least three years.[577] Beginning on January 1, 1998, rural carriers shall receive high cost loop support, DEM weighting assistance, and LTS benefits on the basis of the modified support mechanisms.

384. In our *Universal Service Order*, we adopt modified per-line support mechanisms for providing support comparable to the LTS support received under the existing mechanisms. Beginning on January 1, 1998, we will allow a rural carrier's annual LTS support to increase from its support for the preceding calendar year based on the percentage of increase of the nationwide average loop cost.[578] Rural, non-price cap LECs should continue to apply any revenues received from the modified universal service support mechanisms that replace current LTS amounts to the accounts to which they are currently applying LTS support.

385. We also decide in the *Universal Service Order* that, from January 1, 1998 through December 31, 1999, rural carriers shall calculate their high cost support using the current high cost formulas. We conclude that no adjustment to rural incumbent LECs' interstate access charges is necessary at this time because incumbent LECs will continue to use the existing high cost formulas to determine high cost support. As we determine in that order, however, beginning January 1, 2000, rural carriers shall receive high cost loop support for their average loop costs that exceed 115 percent of an inflation-adjusted nationwide average loop cost. The inflation adjusted nationwide average cost per loop shall be calculated by multiplying the 1997 nationwide average cost per loop by the percentage in change in Gross Domestic Product Chained Price Index (GDP-CPI) from 1997-1998.[579] We conclude that rural, non-price cap LECs should continue to apply any revenues received from the modified universal service support mechanism that replace amounts received under the current high cost support system to the accounts to which they are currently applying high cost support.

386. Finally, in our *Universal Service Order*, we adopt the Joint Board's

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[576] *See* 47 U.S.C. § 153(37).

[577] *See* Section VII.D.2 of the *Universal Service Order*.

[578] *See* Section VII.D.2 of the *Universal Service Order*.

[579] *See* Section VII.D.2 of the *Universal Service Order*. The inflation adjusted nationwide average loop cost for the year 2000 shall be calculated in the following manner: 1998 GDP-CPI X 1997 nationwide average loop cost = 2000 inflation adjusted nationwide average loop cost.

recommendation that a subsidy corresponding in amount to that generated formerly by DEM weighting be recovered from the new universal service support mechanisms.[580] Beginning on January 1, 1998 and continuing until permanent mechanisms for them become effective, rural carriers will receive DEM weighting assistance calculated as follows: assistance will equal the difference between the 1996 weighted DEM factor and the unweighted DEM factor multiplied by the annual unseparated local switching revenue requirement. As with comparable LTS and high cost support, rural, non-price cap LECs should continue to apply any support received from the modified universal service support mechanisms that replaces existing DEM weighting amounts to the accounts to which they are currently applying DEM weighting assistance.

387. Currently, the high cost and DEM weighting support mechanisms shift a portion of the intrastate revenue requirement to the interstate jurisdiction in order to permit LECs to recover a greater percentage of their costs from the interstate jurisdiction. Some non-price cap LECs are concerned that, to the extent that support from the modified universal service mechanisms is not applied to the intrastate jurisdiction, an intrastate revenue shortfall will occur.[581] In the *Universal Service Order*, we conclude that, until universal service support is based on forward-looking economic cost, carriers should continue to receive amounts from the new universal service mechanisms comparable to existing high cost and DEM weighting support. In that order, we do not alter the existing revenue-shifting mechanisms in place for the current high cost support and DEM weighting at this time.[582] Thus, no intrastate revenue shortfall will occur, because no revenue requirement is being shifted back to the intrastate jurisdiction.

E. Part 69 Allocation Rules

1. Background

388. In the NPRM, we solicited comment on whether it would be appropriate for incumbent price cap LECs to be relieved of complying with Subparts D and E of Part 69 of our rules, which address the allocation of investments and expenses to the access rate elements.[583]

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[580] *See* Section VII of the *Universal Service Order*.

[581] *See, e.g.*, Roseville Tel. Comments at 16.

[582] *See* Section VII.D of the *Universal Service Order*.

[583] NPRM at ¶ 294.

2. Discussion

389. We conclude that at this time we should maintain our Part 69 cost allocation rules. In this Report and Order, we have instituted a phasing out of the CCL charge. Until the per-minute CCL charge is phased out completely and multi-line PICCs do not recover any common line revenues,[584] price cap LECs will need to use these rules to calculate the SLC. Therefore, we decline to eliminate the cost allocation rules at this time. We note that we may revisit this issue when these rules are no longer needed to calculate the SLC.

F. Other Proposed Part 69 Changes

1. Background

390. In the NPRM, we sought comment on revisions necessary to update Part 69 and conform it to the 1996 Act. In the NPRM, we made several proposals that we thought necessary to bring Part 69 current, including: eliminating the rules that provide for a "contribution charge" that may be assessed on special access and expanded interconnection; removing the rule and sections referencing the rule that establishes the equal access rate element; and removing the rule and sections referencing the rule that establishes a rate element for costs associated with lines terminating at "limited pay telephones"; and changing the definition of "Telephone Company" to mean incumbent LEC. We also sought comment on whether rate elements and subelements established pursuant to waiver should be incorporated into Part 69.[585]

2. Discussion

391. The passage of the 1996 Act and the subsequent enactment of implementing regulations requires that we update and revise various sections of Part 69. Sections 69.4(f) and 69.122 of our rules provide for a "contribution charge" that may be assessed on special access and expanded interconnection. These sections are inconsistent with section 254 as amended by the 1996 Act, which requires, *inter alia*, that such carrier contributions be equitable and nondiscriminatory. Furthermore, our rules governing the contribution charge merely allow a LEC to try to justify this charge in the expanded interconnection context. No party has even attempted to justify such a charge in more than four years. Given this and the relevant amendments in the 1996 Act, we find that there is no need for this rate element. We conclude that sections 69.4(f) and 69.122 of our rules, which provide for a "contribution charge" that may be assessed on special access and expanded interconnection, should be deleted.

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[584] *See* Section III.A.

[585] NPRM at ¶¶ 295-299.

392. Under Part 69, we required carriers to eliminate any separate equal access charge by January 1, 1994.[586] We conclude, therefore, that section 69.4(d), which established the equal access rate element for a limited duration, should be deleted because of the expiration of the designated time period. Similarly, we conclude that section 69.107, which governs the computation of the equal access rate element charges, and sections 69.308 and 69.410, which concern allocation of costs to that rate element, should be deleted because the designated time period for separate equal access rate elements has expired. We conclude that references to these deleted sections should also be removed from Part 69.[587] To ensure consistency, a new section, designated as section 69.3(3)(12), should be added and should read as follows: "Such a tariff shall not contain any separate carrier's carrier tariff charges for an Equal Access element." Similarly, we conclude that section 69.205, which concerns transitional premium charges for IXCs and others should be deleted because the designated transition period for these charges has expired.

393. Section 69.103 requires incumbent LECs to establish a separate rate element for costs associated with lines terminating at "limited pay telephones."[588] Sections 69.303(a), 69.304(c), 69.307(c), and 69.406(a)(9) concern the allocation of costs to this rate element. Section 276 of the Act and the implementing regulations require a new per call compensation plan, which requires, *inter alia*, that incumbent LECs remove all payphone costs from access charges.[589] This new compensation plan, as well as the payphone dialing parity requirements,[590] have eliminated the need for sections 69.103, 69.303(a), 69.304(c), 69.307(c), and 69.406(a)(9). We conclude that these sections should be deleted.

394. We conclude that codifying previously-granted Part 69 waivers is not necessary at this time. Under the *Price Cap Performance Review Third Report and Order*, a party seeking to introduce a new service may do so by filing a petition showing that the new service is in the public interest.[591] Once that petition for a new service has been granted, carriers seeking to introduce the same service with the same rate structure may do so under

[586] 47 C.F.R. § 69.4(d).

[587] Section 69.309 refers to section 69.308 and section 69.411 refers to section 69.410.

[588] We note that few, if any, payphone service providers offer this type of service today.

[589] Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Report and Order, CC Docket No. 96-128, FCC 96-388 (rel. Sep. 20, 1996) (*Payphone Order*), *recon.*, FCC 96-439 (rel. Nov. 8, 1996) (*Payphone Reconsideration Order*), *appeal docketed sub nom.*, *Illinois Public Telecommunications Ass'n v. FCC and United States*, Case No. 96-1394 (D.C. Cir., filed Oct. 17, 1996).

[590] *Payphone Order* at ¶¶ 291-293.

[591] NPRM at ¶ 309.

expedited procedures.[592] This streamlined alternative for introducing new services should resolve past difficulties encountered with the Part 69 waiver process. The proposed codification of previously-granted waivers is thus unnecessary. We therefore decline to codify previously-granted Part 69 waivers into our rules.

395. NECA and TCA have requested that the Commission extend to all rate-of-return companies, the right to offer new services based on an expedited process, which requires, *inter alia*, a showing that the new service is in the public interest. In the Third Report and Order, we granted to incumbent price cap LECs the right to introduce new services under a streamlined procedure.[593] We will address the request of NECA and TCA when we take up access reform for rate-of-return companies in the near future.

396. In the NPRM, we solicited comment on whether we should adopt regulatory requirements to govern rates for terminating access offered by competitive LECs. In Section VI.C., *supra*, we conclude that we will not adopt such regulatory requirement at this time. For the same reasons, we find it unnecessary to apply any of our Part 69 regulations to competitive LECs. We therefore conclude that Section 69.2(hh), which currently defines "Telephone Company" by reference to Section 3(r) of the 1934 Act, should be changed to read as follows: "'Telephone Company' or 'local exchange carrier' as used in this Part means an incumbent local exchange carrier as defined in section 251(h)(1) of the 1934 Act as amended by the 1996 Act." There is no indication in the record that competitive LECs have exercised any degree of market power in provision of terminating access or other access services. By definition, non-dominant carriers do not exercise market power. Further, non-dominant carriers possess a negligible share of the current access market and they will be competing with incumbent LECs whose rates are subject to regulation. As a practical matter, the rates of the incumbent LECs will serve as a constraint to some degree on the pricing and practices of non-dominant LECs. We therefore find on this record that it is sufficient to rely on the Section 208 complaint process to assure compliance with the Act by competitive LECs, and that we should not apply Part 69 to them. To the extent that our definitions or our application of Part 69 needs in the future to be expanded to encompass LECs other than incumbent LECs, we can revisit this issue.

VII. FURTHER NOTICE OF PROPOSED RULEMAKING

A. PICCs for Special Access Lines

397. In this Further Notice of Proposed Rulemaking, we seek comment on our proposal to allow incumbent local exchange carriers to impose a PICC on special access lines.

[592] NPRM at ¶ 310.

[593] NPRM at ¶¶ 309-310.

1. Background

398. As discussed in Section III.A., in most cases, the \$3.50 SLC ceiling for primary residential and single-line business customers does not allow recovery through the SLC of the average per-line common line revenues permitted under our price cap rules. Similarly, in certain service areas, the \$6.00 SLC for multi-line business lines is insufficient to recover the average per-line revenues permitted by price cap regulation. To alleviate this shortfall, we are instituting a number of changes, including raising the ceiling on the SLC for multi-line business and second and additional residential lines.[594] Although this increase in the SLC will recover some of the shortfall, other measures are needed to allow recovery of the common line revenues permitted under our rules.

399. Therefore, we have permitted LECs to recover common line revenues not recovered from the SLC by assessing flat, per-line charges on the end-user's presubscribed interexchange carrier. Specifically, we are permitting LECs to assess a PICC on all lines, subject to ceilings which will be increased each year. To the extent that the revenues from SLCs and PICCs on primary residential lines and single-line business lines are insufficient to recover the full common line revenues permitted by our price cap rules for these lines, or the multi-line SLCs are at their ceilings, incumbent LECs shall recover the difference by assessing an additional PICC on non-primary residential and multi-line business lines. To the extent that these PICCs do not recover an incumbent LEC's remaining permitted CCL revenues, incumbent LECs generally shall recover any such residual common line revenues through per-minute CCL charges assessed on originating access minutes.

400. As a result of our new rules, certain multi-line businesses will be paying higher SLCs than they do now. Similarly, as the PICCs are phased in, IXCs initially will be required to pay higher PICCs for a multi-line business end user compared to the PICC paid for a primary residential end user or a single-line business end user.

401. In contrast, users of special access do not pay a SLC. Furthermore, under special access, IXCs do not incur the same local access charges that are incurred by end users using switched access. In light of our most recent changes to charges incurred by multi-line businesses, including the higher SLC and the new multi-line business PICC, it may be cost effective for some multi-line businesses that are currently using switched access to purchase instead special access lines.

402. We are concerned that these facts could lead to the migration of certain businesses from the public switched network to special access, which would result in a decrease in projected revenue from multi-line SLCs. As a result PICCs for all remaining switched access lines will necessarily increase to make up for the loss of revenue.

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[594] *See* Section III.A. for additional revisions to the recovery of common line revenues.

2. Proposal

403. We tentatively conclude that we should permit price cap LECs to assess a PICC on special access lines to recover revenues for the common line basket. The special access PICC would be no higher than the PICC that an incumbent LEC could charge for a multi-line business line. Under our proposal, the special access PICC would not recover TIC or marketing expense.

404. We acknowledge that our proposal is a departure from established Commission practice that special access will not subsidize other services. Although our proposal is a subsidy, it is temporary in nature and will be phased out as the single-line PICC is phased in. We tentatively conclude that our proposal is necessary for our transition from the per-minute CCL charge to the flat PICC to work.

405. We invite parties to comment on this proposal. We also seek comment on how special access connections should be counted for purposes of assessing a "per line" PICC. Parties should also address the extent to which our proposal affects large and small LECs differently and how small business entities, including small incumbent LECs and new entrants, will be affected.[595]

406. Consistent with our approach to reform the interstate access charge regime, however, we tentatively conclude that the scope of this proceeding should be limited to incumbent price cap LECs. As discussed in Section V., *supra*, we have limited the scope of access reform, with some limited exceptions, to price cap incumbent LECs.[596] Similarly, we limit the scope of this NPRM. To the extent necessary, we will instead address the effect of these issues on rate-of-return carriers in our separate access reform proceeding for rate-of-return carriers in 1997. In that proceeding, we will have the opportunity to conduct a comprehensive review of the circumstances unique to these carriers. We seek comment on this tentative conclusion regarding the scope of this proceeding. We also invite parties to identify any changes that should be made to other access elements as a result of this proposed change.

B. General Support Facilities Costs

407. As discussed in Section IV. D above, the current allocation of GSF costs enables incumbent LECs to recover through regulated interstate access charges costs associated with

[595] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

[596] These incumbent LECs are the seven Regional Bell Operating Companies (Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, SWBT, U S West), Citizens, Frontier, GTE, Aliant (formerly Lincoln), SNET, and United/Central.

the LECs' nonregulated billing and collection functions. In this section, we seek comment on proposed changes in the allocation of price cap LECs' interstate costs between regulated interstate services and nonregulated billing and collection activities.

1. Background

408. The costs that incumbent LECs recover through interstate access charges are determined by a multi-step process. Incumbent LECs first record their investment costs and booked expenses in the accounts prescribed by the Commission's Part 32 Uniform System of Accounts (USOA).[597] They next divide the recorded investment and expenses between regulated and nonregulated services pursuant to Part 64 of the Commission's rules. Incumbent LECs then divide regulated expenses and investment costs between the state and interstate jurisdictions pursuant to the separations procedures prescribed in Part 36 of the Commission's rules.[598] Finally, in accordance with our Part 69 access charge rules, the LEC apportions its regulated interstate costs among the interstate access and interexchange service categories.[599]

409. Because the Part 69 access charge rules are applied at the end of this multi-step process, they are written to accommodate the accounts defined by the USOA and the cost categories prescribed by the Separations Manual. In 1987, the Commission revised its access charge rules[600] in response to the Commission's comprehensive revision of both the USOA[601] and the Separations Manual.[602] In its *Part 69 Conformance Order*, the Commission amended Part 69 to reapportion regulated interstate costs, including General Support Facilities (GSF) investment expenses, among the existing access elements.

410. As discussed in Section IV.D above, the GSF investment category in Part 36

[597] *See* 47 C.F.R. Part 32.

[598] *See* 47 C.F.R. Part 36.

[599] *See* 47 C.F.R. Part 69.

[600] Amendment of Part 69 of the Commission's Rules and Regulations, Access Charges, To Conform It With Part 36, Jurisdictional Separations Procedures, CC Docket No. 87-113, Report and Order, 2 FCC Rcd 6447 (1987) (*Part 69 Conformance Order*).

[601] Revision of the Uniform System of Accounts and Financial Reporting Requirements for Class A and Class B Telephone Companies (Parts 31, 33, 42, and 43 of the FCC's Rules), CC Docket No. 78-196, Report and Order, FCC 86-221 (rel. May 15, 1986) (creating Part 32 of the Commission's rules).

[602] MTS and WATS Market Structure, Amendments of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Docket Nos. 78-72, 80-286, and 86-297, Report and Order, 2 FCC Rcd 2639 (1987). *See* Part 36 of the Commission's rules, 47 C.F.R. Part 36.

includes assets that support other operations, such as land, buildings, vehicles, as well as general purpose computer investment accounted for in USOA Account 2124.[603] Some incumbent LECs use general purpose computer equipment, which is included in the GSF investment category, to provide nonregulated billing and collection services to IXCs.[604] The costs of providing interstate billing and collection service are not, however, treated as nonregulated in the Part 64 cost allocation process. Instead, nonregulated interstate billing and collection costs are identified through the Part 36 and Part 69 cost allocation process. The separations process allocates these costs to the various separations categories based on the separations of the three largest categories of expenses, *i.e.*, plant specific expenses, plant non-specific expenses, and customer operations expenses.[605]

411. In its comments in response to the NPRM, AT&T refers to the allocation of embedded GSF expenses, including general purpose computer expenses, among access categories as a misallocation resulting in an implicit cross-subsidy of incumbent LECs' nonregulated billing and collection services. This allocation, AT&T contends, results in the inappropriate support through regulated access charges of LECs' billing and collection service, which is a nonregulated, interstate service. AT&T estimates that $124 million of expenses recovered in interstate access support the nonregulated billing and collection category.[606] Of the $124 million, AT&T states that $60.1 million is included in interstate switched access, and $20.5 million is in interstate special access, with the remainder recovered by the SLC.[607]

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[603] *See* 47 C.F.R. § 36.111.

[604] In 1986, the Commission found that the market for billing and collection service was sufficiently competitive that it was not necessary to require LECs to provide that service as a tariffed common carrier service. The Commission did not, however, pre-empt state regulation of billing and collection services. *See* Detariffing of Billing and Collection Services, CC Docket No. 85-88, 102 FCC 2d 1150 (1986) (*Billing and Collection Detariffing Order*); *recon. denied*, 1 FCC Rcd 445 (1986). The Commission later decided to treat billing and collection costs as regulated for accounting purposes because it found that such treatment was less likely to misallocate these costs between the interstate and intrastate jurisdictions. Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298, 1309 (1987) (*Joint Cost Order*).

[605] These three largest categories, or the "Big Three Expenses," are the combined expense groups comprising: (1) Plant Specific Operations Expense, Accounts 6110, 6120, 6210, 6220, 6230, 6310, and 6410; (2) Plant Nonspecific Operations Expenses, Accounts 6510, 6530, and 6540; and (3) Customer Operations Expenses, Accounts 6610 and 6620. 47 C.F.R. § 69.2(e). The "Big Three Expense Factors" are the ratios of the sum of Big Three Expenses apportioned to each element or category to the combined Big Three Expenses. 47 C.F.R. § 69.2(f).

[606] AT&T Comments at 67-68, Appendix E at 2.

[607] AT&T Comments Appendix E at 2.

2. Proposal

412. The failure of Part 69 to assign general purpose computer costs to the billing and collection category can be traced to our decision in the *Part 69 Conformance Order* to use an investment-based allocator to apportion general support facilities (GSF) investment.[608] As discussed in Section IV.D above, Section 69.307 of the Commission's rules apportions GSF investment among the billing and collection category, the interexchange category, and the access elements based on the amount of Central Office Equipment (COE), Cable and Wire Facilities (CWF), and Information Origination/Termination Equipment (IO/T) investment allocated to each Part 69 category.[609] This rule appears on its face to provide for an allocation of GSF investment to billing and collection. Because no COE, CWF, or IO/T investment is allocated to the billing and collection category, however, no GSF investment, and thus no portion of general purpose computer investment, is allocated to the billing and collection category. Similarly, because expenses related to GSF investment are allocated in the same manner as GSF investment, no GSF expenses (including expenses related to general purpose computers) are allocated to billing and collection. Price cap LECs' costs allocated to the interstate billing and collection category are estimated to be approximately $480 million.[610]

413. As discussed in Section V of the *Access Reform Order*, we limit the scope of access reform, with some limited exceptions, to price cap incumbent LECs. Consistent with our approach to reform the interstate access charge regime, we tentatively conclude that our proposed changes to the allocation of GSF investment will apply only to price cap LECs. We will address the misallocation of rate-of-return LECs' interstate costs between regulated interstate services and nonregulated billing and collection activities in our separate access reform proceeding for rate-of-return carriers in 1997, which will provide us with the opportunity to conduct a comprehensive review of the circumstances unique to these carriers. We seek comment on this tentative conclusion regarding the scope of this proceeding.

414. To the extent that incumbent LECs' costs are underallocated to the billing and collection category, incumbent LECs' regulated services are recovering through interstate access charges costs associated with unregulated services. We therefore tentatively conclude that price cap incumbent LECs' general purpose computer costs attributable to billing and collection should not be recovered through regulated access charges. We seek comment on two options for reassigning these costs to the billing and collection category.

415. Under the first option, a price cap LEC would study the uses of the general

[608] *Part 69 Conformance Order*, 2 FCC Rcd at 6452.

[609] 47 C.F.R. § 69.307(c).

[610] 1996 ARMIS Access Report.

purpose computer assets recorded in Account 2124 to determine the percentage of investment in that account that is used for billing and collection activities.[611] That percentage, multiplied by the ratio of the dollar amount in Account 2124 to the dollar amount in Account 2110,[612] which accumulates the total GSF investment, would be applied to the interstate portion of Account 2110 to determine a dollar amount that represents general purpose computer assets used for interstate billing and collection activities. The dollar amount so identified would be attributed directly to the billing and collection category. The remainder of the interstate portion of Account 2110 shall be apportioned among the access elements and the interexchange category using the current investment allocator. General purpose computer expenses recorded in Account 6124 would be treated in a similar fashion to Account 2124.[613] The interstate portion of Account 6124 would be allocated between (a) the billing and collection category and (b) all other elements and categories using the percentage derived for Account 2124. The remainder of Account 6120 (GSF expense) would be apportioned based on current GSF allocators.[614] Appropriate downward exogenous cost adjustments would be made to all price cap baskets.

416. Two objections are commonly raised to the use of special studies to make regulatory cost allocations. First, such studies are said to be costly. We recognize that there are costs attached to a special study approach. We note, however, that price cap LECs may already be required to study the use of computer investment in Account 2124 as part of the process of allocating that investment between regulated and nonregulated activities pursuant to the Part 64 joint cost rules. Second, it may be claimed that permitting price cap LECs to use special studies gives them too much discretion and that regulators are unable to ascertain the validity of the studies. To remedy this concern, we propose that each price cap LEC add to its cost allocation manual (CAM) a new section entitled "Interstate Billing and Collection." That section would describe: (1) the manner in which the price cap LEC provides interstate billing and collection services, and (2) the study it uses to determine the portion of Account 2124 investment that it attributes to the billing and collection category. The special study would then be subject to the same independent audit requirements as other regulated and nonregulated cost allocations. In addition, to obtain an independent certification of the validity of the procedures adopted by the price cap LEC, we would instruct the independent auditors to examine the design and execution of the study during the first independent audit following the addition of the billing and collection section to the CAM and to report their conclusions on the validity of the study.

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[611] Investment in general purpose computer equipment is recorded in Account 2124. *See* 47 C.F.R. § 32.2124.

[612] Investment in land and support assets is recorded in Account 2110. *See* 47 C.F.R. § 32.2110.

[613] General purpose computers expenses are recorded in Account 6124. *See* 47 C.F.R. § 32.6124.

[614] General support expenses are recorded in Account 6120. *See* 47 C.F.R. § 32.6120.

417. Under the second option, we would modify Section 69.307 of our rules to require use of a general expense allocator to allocate the interstate portion of Account 2110 between: (1) the billing and collection category, and (2) all other elements and categories. We propose to use the "Big Three Expense" allocator used elsewhere in Part 69,[615] excluding, however, any account or portion of an account that is itself apportioned based on the apportionment of GSF to avoid circularity. The GSF investment not allocated to the billing and collection category would then be apportioned among the access elements and the interexchange category using the current investment allocator. This would ensure that GSF costs are allocated among all access categories, including the billing and collection category. The interstate portion of Account 6120 would be apportioned among all elements and categories based on the overall apportionment of GSF investment. This option covers only price cap incumbent LECs that provide interstate billing and collection using regulated assets. Carriers that acquire billing and collection services from unregulated affiliates through affiliate transactions or from third parties would continue recording their expenses for acquiring such services in Account 6623,[616] which is already apportioned to the billing and collection category.

418. We invite parties to comment on the feasibility of these two options and propose alternative methods for reassigning general purpose computer costs to the billing and collection category. Parties should also address the extent to which either option affects large and small LECs differently and how small business entities, including small incumbent LECs and new entrants, will be affected.[617] We invite parties to identify any changes that should be made to other access elements as a result of any changes we may make to the GSF allocation procedures.

VIII. FINAL REGULATORY FLEXIBILITY ANALYSIS

419. As required by the Regulatory Flexibility Act (RFA),[618] an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the NPRM in this proceeding.[619] The Commission sought written public comments on the proposals in the NPRM, including the IRFA. The Commission's Final Regulatory Flexibility Analysis (FRFA) in this Order (the First Report and Order in this Access Charge Reform proceeding) conforms to the RFA, as

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[615] *See* 47 C.F.R. § 69.2(f).

[616] *See* 47 C.F.R. § 32.6623.

[617] *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

[618] *See* 5 U.S.C. § 603.

[619] NPRM at ¶¶ 321-37.

amended.[620] We provide this summary analysis to provide context for our analysis in this FRFA. To the extent that any statement contained in this FRFA is perceived as creating ambiguity with respect to our rules or statements made in preceding sections of this Order, the rules and statements set forth in those preceding sections shall be controlling.

A. Need for and Objectives of this First Report and Order

420. The Telecommunications Act of 1996 requires incumbent LECs to offer interconnection and unbundled elements on an unbundled basis, and imposes a duty to establish reciprocal compensation arrangements for the transport and termination of calls. The Commission's access charge rules were adopted at a time when interstate access and local exchange services were offered on a monopoly basis, and in many cases are inconsistent with the competitive market envisioned by the 1996 Act. This proceeding is being conducted to revise the Commission's access charge rules to make them consistent with the Telecommunications Act of 1996.

B. Summary of Significant Issues Raised by the Public Comments in Response to the IRFA

421. Only one party, Rural Tel. Coalition, commented on the IRFA contained in the NPRM. Rural Tel. Coalition disagrees with our conclusion that rules applying only to price cap LECs will not affect non-price cap LECs in a way that requires analysis under the RFA. According to Rural Tel. Coalition, the decisions made in this Order will "prejudge and prejudice" a later rulemaking addressing access charge reform for non-price cap LECs.[621] In addition, Rural Tel. Coalition argues that non-price cap LECs, which include small incumbent LECs, will be injured if the access reform issues addressed in this Order are not implemented for them as well as price-cap LECs. Finally, Rural Tel. Coalition argues that the Commission impermissibly determined that small incumbent LECs are not small businesses within the meaning of the RFA.[622]

422. Rather than attempt to enact "one size fits all" access charge reform that would risk not fully accounting for the special circumstances of rate-of-return and other non-price cap LECs, we have chosen to address those LECs separately in a proceeding in which we may better focus on their needs. We do not agree with Rural Tel. Coalition that our decisions

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[620] *See* 5 U.S.C. § 604. The Regulatory Flexibility Act, 5 U.S.C. § 601 *et. seq.*, was amended by the "Small Business Regulatory Enforcement Fairness Act of 1996" (SBREFA), which was enacted as Title II of the Contract With America Advancement Act of 1996, Pub.L. No. 104-121, 110 Stat. 847 (1996) (CWAAA).

[621] Rural Tel. Coalition Comments at 4, 32.

[622] *Id.* at 32-35.

in this Order will "prejudge and prejudice" our consideration of the issues in a subsequent rulemaking. Although we may often find that the public interest concerns are similar for large and small carriers, our analysis will begin anew, and will address all relevant factors. Moreover, where the special circumstances faced by small incumbent LECs justify different treatment than is accorded price cap LECs in this Order, we will be better able to explain and address those concerns in a separate proceeding. For the reasons set forth in Section V above, we also disagree with Rural Tel. Coalition that small incumbent LECs may be injured by the delay involved in conducting separate rulemakings. Finally, although we are not persuaded on the basis of this record that our prior practice of finding incumbent LECs not subject to regulatory flexibility analysis (because they are not small businesses) has been incorrect,[623] we have fully performed an RFA analysis for small incumbent LECs in this Order, including consideration of any adverse impact of the rules we adopt and consideration of alternatives that may reduce adverse impacts on such entities.

C. Description and Estimate of the Number of Small Entities To Which the Rules Will Apply:

423. The RFA generally defines "small entity " as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."[624] In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act unless the Commission has developed one or more definitions that are appropriate for its activities.[625] A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).[626]

424. Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register." SBA has developed a definition of small business for Standard Industrial Classification (SIC) category 4813 (Telephone Communications, Except

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[623] *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499 ¶¶ 1328-30 (1996) (*Local Competition Order*), *motion for stay denied*, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Order, 11 FCC Rcd 11754 (1996), *partial stay granted*, *Iowa Utilities Board v. FCC*, No. 96-3321, 1996 WL 589204 (8th Cir. 1996).

[624] 5 U.S.C. § 601(6).

[625] 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 15 U.S.C. § 632).

[626] Small Business Act, 15 U.S.C. § 632 (1996).

Radiotelephone). We first discuss the number of small businesses falling within this category, and then we attempt to refine further our estimate to correspond with the categories of telephone companies that are commonly used under our rules.

425. Consistent with our prior practice, our use of the terms "small entities" and "small businesses" does not encompass "small incumbent LECs." We use the term "small incumbent LECs" to refer to any incumbent LECs that arguably might be defined by SBA as "small business concerns."[627] Because the small incumbent LECs subject to these rules are either dominant in their field of operations or are not independently owned and operated, they are, consistent with our prior practice, excluded from the definition of "small entity" and "small business concerns."[628] Out of an abundance of caution, however, for regulatory flexibility analysis purposes, we will consider small incumbent LECs within this analysis and use the term "small incumbent LECs" to refer to any incumbent LECs that arguably might be defined by the SBA as "small business concerns."[629]

1. Telephone Companies, Except Radiotelephone Companies (SIC 4813)

426. *Total Number of Telephone Companies Affected.* The United States Bureau of the Census ("the Census Bureau") reports that, at the end of 1992, there were 3,497 firms engaged in providing telephone services, as defined therein, for at least one year.[630] This number contains a variety of different categories of carriers, including local exchange carriers, interexchange carriers, competitive access providers, cellular carriers, mobile service carriers, operator service providers, pay telephone operators, personal communications services providers, covered specialized mobile radio providers, and resellers. It seems certain that some of those 3,497 telephone service firms may not qualify as small entities or small incumbent LECs because they are not "independently owned and operated."[631] For example, a PCS provider that is affiliated with an interexchange carrier having more than 1,500 employees would not meet the definition of a small business. It seems reasonable to conclude that fewer than 3,497 telephone service firms are small entity telephone service firms or small incumbent local exchange carriers.

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[627] *See* 13 C.F.R. § 121.210 (SIC 4813).

[628] *See Local Competition Order*, 11 FCC Rcd at 15499 ¶¶ 1328-30, 1342.

[629] *Id.*

[630] United States Department of Commerce, Bureau of the Census, *1992 Census of Transportation, Communications, and Utilities: Establishment and Firm Size*, at Firm Size 1-123 (1995) (*1992 Census*).

[631] 15 U.S.C. § 632(a)(1).

427. According to the *Telecommunications Industry Revenue: Telecommunications Relay Service Fund Worksheet Data (TRS Worksheet)*, there are 2,847 interstate carriers. These carriers include, *inter alia*, local exchange carriers, wireline carriers and service providers, interexchange carriers, competitive access providers, operator service providers, pay telephone operators, providers of telephone toll service, providers of telephone exchange service, and resellers.

428. *Wireline Carriers and Service Providers.* The SBA has developed a definition of small entities for telephone communications companies other than radiotelephone (wireless) companies. According to the SBA's definition, a small business telephone company other than a radiotelephone company is one employing no more than 1,500 persons.[632] The Census Bureau reports that, there were 2,321 such telephone companies in operation for at least one year at the end of 1992.[633] All but 26 of the 2,321 non-radiotelephone companies listed by the Census Bureau were reported to have fewer than 1,000 employees. Thus, even if all 26 of those companies had more than 1,500 employees, there would still be 2,295 non-radiotelephone companies that might qualify as small entities or small incumbent LECs. We do not have information on the number of carriers that are not independently owned and operated, and thus are unable at this time to estimate with greater precision the number of wireline carriers and service providers that would qualify as small business concerns under the SBA's definition. Consequently, we estimate that there are fewer than 2,295 small telephone communications companies other than radiotelephone companies.

429. *Incumbent Local Exchange Carriers.* Neither the Commission nor the SBA has developed a definition for small incumbent providers of local exchange services (LECs). The closest applicable definition under the SBA rules is for telephone communications companies other than radiotelephone (wireless) companies.[634] The most reliable source of information regarding the number of LECs nationwide is the data that we collect annually in connection with the *TRS Worksheet*. According to our most recent data, 1,347 companies reported that they were engaged in the provision of local exchange services.[635] We do not have information on the number of carriers that are not independently owned and operated, nor what carriers have more than 1,500 employees, and thus are unable at this time to estimate with greater precision the number of incumbent LECs that would qualify as small business concerns under SBA's definition. Consequently, we estimate that there are fewer than 1,347 small incumbent

[632] 13 CFR § 121.201, SIC Code 4812.

[633] *1992 Census*, *supra*, at Firm Size 1-123.

[634] 13 CFR § 121.201, SIC Code 4813.

[635] Federal Communications Commission, CCB, Industry Analysis Division, *Telecommunications Industry Revenue: TRS Fund Worksheet Data*, Tbl. 1 (Average Total Telecommunications Revenue Reported by Class of Carrier) (December 1996) (*TRS Worksheet*).

LECs.

2. Information Service Providers and Competitive LECs Are Not Affected

430. In Section VIII.B of the NPRM, we sought comment on whether to continue to exempt enhanced service providers (which we now refer to as information service providers, or ISPs) from any requirement to pay access charges. Because we decide to retain the ISP exemption, and do not permit LECs to impose access charges on ISPs at this time, we conclude that the RFA does not require us to consider the effects of any proposed rules on ISPs that fall within the definition of a small entity. Instead, as set forth in Section VI.B above, we find that the proceeding commenced with the Notice of Inquiry issued contemporaneously with the NPRM is the appropriate forum to address the fundamental questions about ISP usage of the public switched network.[636] Similarly, we sought comment in Section VIII.A of the NPRM on whether the public interest would be served by regulating interstate terminating access services offered by competitive (non-incumbent) LECs. Because we conclude that the public interest would not be served by imposing any regulations on competitive LECs' interstate terminating access offerings at this time, we conclude that the RFA does not require us to consider the effects of any proposed rules on competitive LECs that fall within the definition of a small entity.

D. Summary Analysis of the Projected Reporting, Recordkeeping, and Other Compliance Requirements

431. In Section V.A above, we adopt changes to transport interconnection charge (TIC) rate structures and transport rate structures to comply with the court order in *CompTel v. FCC*.[637] These changes will affect all incumbent LECs, including small incumbent LECs, and will require small incumbent LECs to make one or more tariff filings reflecting the new rate structures, which will involve the use of legal skills, and possibly accounting, economic, and financial skills.

432. As set forth in Section VI.D above, incumbent LECs, including small incumbent LECs, must reduce their interstate access charges to reflect the elimination of those former

[636] *See In the Matter of* Usage of the Public Switched Network by Information Service and Internet Access Providers, Notice of Inquiry, CC Docket No. 96-263, __ FCC Rcd _____ (1996), __ Fed. Reg. _____ (Released December 24, 1996) (NOI). In the NOI, we sought comment on broader issues concerning the development of information services and Internet access. The information provided will give us the data we need to make further reasonable and informed decisions regarding Internet access and other information services, and, if necessary, to craft proposals for a subsequent Notice of Proposed Rulemaking that are sensitive to the complex economic, technical, and legal questions raised in this area.

[637] *CompTel v. FCC,* 87 F.3d 522 (D.C.Cir. 1996).

universal service obligations that are being replaced with new universal service obligations, increase their interstate access charges to reflect their new universal service obligations, and, to the extent necessary, adjust their interstate access charges to account for any additional universal service funds received under the modified universal service mechanisms. This will require small incumbent LECs to make one or more tariff filings, which will involve the use of legal skills.

E. Burdens on Small Entities, and Significant Alternatives Considered and Rejected

433. *Sections III.C-D: Transport/TIC Rate Structure Changes.* As set forth in Sections III.C-D above, we adopt a new tandem-switched transport rate structure and rate levels that replace the interim rate structure in place prior to today. In addition, we adjust the TIC to reflect the changes made by the new tandem-switched transport rate structure and rate levels. Unlike before, we adopt for the first time a final, cost-based rate structure, which should reduce and minimize uncertainty for those small businesses and small incumbent LECs whose businesses involve these services. Moreover, the new rate structure and rate levels are more closely related to the costs of providing the underlying services, which should minimize the economic impact of these rules on small businesses and small incumbent LECs by minimizing the adverse impacts that can accompany non-cost based regulation.[638]

434. We also adopt a transition plan that will have the effect of giving small businesses and small incumbent LECs the opportunity to plan, adjust, and develop their networks with a minimum of disruption for them and their customers. Finally, as set forth in Section III.C-D above, we find that the reallocation of TIC costs and the new recovery procedures will facilitate the development of competitive markets. This is because incumbent LEC rates will move toward cost-based levels and incumbent LECs will no longer have the ability to assess TICs on switched access minutes that do not use their transport facilities. These pricing revisions may create new opportunities for small entities, including small business and small incumbent LECs wishing to enter local telecommunications markets.

435. *Section V: Access Reform for Incumbent Rate-of-Return Local Exchange Carriers.* Our decision to limit access charge reform, with certain specified exceptions, to price cap LECs, which do not include small businesses or small incumbent LECs, should mitigate the potential that access charge reform could have a significant economic impact on any small incumbent LECs. This is because the Commission will address in a separate proceeding the common set of complex issues faced by non-price cap LECs, which are different than those faced by price cap LECs. Moreover, as discussed above in Section V, we find that small incumbent LECs are unlikely to face imminent harm as a result of the continued application of our current access charge rules because all non-price cap incumbent

[638] *See* Section III.C.2.b *supra.*

LECs may be exempt from, or eligible for a modification or suspension of, the interconnection and unbundling requirements of the 1996 Act.

436. *Section VI.A: Applicability of Part 69 to Unbundled Elements.* As a result of the exclusion of unbundled elements from Part 69 access charges, described in Section VI.A above, incumbent LECs, including small incumbent LECs, may receive reduced overall levels of interstate access charges as competitors enter local markets using unbundled network elements. They will, however, receive payment for those unbundled network elements pursuant to interconnection agreements under Section 251 of the Act. Moreover, to the extent that small incumbent LECs receive universal service support through interstate access charges, such funding will continue to be received without regard to any loss of revenue from interstate access charges. This is because all universal service support received by small incumbent LECs will be received from the new Universal Service Fund, established in a separate order released today. Finally, we note that section 251 of the Act contains provisions expressly designed to take into account the special circumstances of small incumbent LECs, including those that qualify as rural LECs, with respect to interconnection obligations.

437. Our decisions in Section VI.A above to exclude unbundled elements from the application of Part 69 access charges is likely to facilitate the development of competitive markets. This is because prices for unbundled elements will reflect the costs of those elements, and will not impose on competitors additional charges unrelated to the costs of elements being purchased. Accordingly, as set forth in Section VI.A above, competitors using unbundled elements will contribute to universal service on an equitable and non-discriminatory basis instead of paying implicit subsidies to incumbent LECs (whether in addition to, or in place of, explicit universal service mechanisms). These decisions may create new opportunities for small entities, including small businesses and small incumbent LECs, wishing to enter local telecommunications markets.

438. *Section VI.C: Terminating Access Services Offered by Non-Incumbent LECs.* As set forth in Section VI.C above, we find that treating new entrants as dominant carriers subject to regulation of their terminating access services until we find otherwise would impose unnecessary regulation, including potentially increased regulatory burdens on small businesses. Instead of imposing such burdens, we find that the imposition of regulatory requirements with respect to competitive LEC terminating access is unnecessary in the absence of some stronger record evidence that competitive LECs have in the past charged unreasonable terminating access rates, or are likely to do so in the future. If there is sufficient indication that competitive LECs are imposing unreasonable terminating access charges, we will revisit this issue.

439. *Section VI.D: Universal Service Related Part 69 Changes*. As set forth in Section VI.D.2.a above, we require that LECs that contribute to the Long Term Support (LTS) program and LECs that receive LTS payments revise their tariffs to reflect the fact that the LTS program is being replaced with explicit support from the new Universal Service Fund implemented pursuant to the *Universal Service Order* adopted today. This will require small incumbent LECs to make one or more tariff filings. The new Universal Service Fund will facilitate the transition to competitive markets while maintaining specific, predictable and sufficient support for universal service as required under section 254 of the Act. Accordingly, the required changes in LECs' tariff filings, including those in tariffs filed by small incumbent LECs, are part of an overall mechanism designed to minimize the economic impact of the 1996 Act on small businesses and small incumbent LECs. The other universal service related changes that we adopt in this Order affect only price-cap LECs, which do not include any small businesses or small incumbent LECs.

F. Report to Congress

440. The Commission shall include a copy of this FRFA, along with this Order, in a report to be sent to Congress pursuant to SBREFA.[639] A copy of this FRFA (or a summary thereof) will also be published in the Federal Register.

IX. PROCEDURAL ISSUES

[639] 5 U.S.C. § 801(a)(1)(A).

A. Paperwork Reduction Act

441. On April 1, 1997, the Office of Management and Budget (OMB) approved all of our proposed information collection requirements in accordance with the Paperwork Reduction Act.[640] The OMB made one recommendation, suggesting that we try "to minimize the number of new filings that firms must create in order to be compliant with the rules adopted . . . allowing firms to use many of the filings they must create in order to demonstrate that they meet the Telecommunications Act of 1996 requirements for provision of inter-LATA services within their operating regions." The recommendation of OMB primarily affects proposals that were not adopted in this Order, but will be the subject of a future Report and Order. At that time, the Commission will consider carefully whether the number of required new filings can be minimized by relying to the greatest extent possible on those filings referenced by OMB in its approval. Furthermore, in this Order, although we have made certain adjustments, we have minimized the paperwork burden where possible. For example, the first inflation adjustment will be done in January 1, 1999, but the next one will not be done until July 1, 2000. This schedule will minimize the number of filings and paperwork burden associated with necessary adjustments for inflation.

442. In the course of preparing this Order, we have decided to modify several of the information collection requirements proposed in the NPRM. For example, price cap local exchange carriers must make a downward exogenous adjustment to the price cap index for the common line basket to account fully for the elimination of their LTS obligations by December 16, 1997 to be effective January 1, 1998.[641] We conclude that these modifications constitute a new "collection of information," within the meaning of the Paperwork Reduction Act of 1995, 44 U.S.C. §§ 3501-3520. These modifications are subject to OMB review and the Commission has requested emergency approval of these modifications to ensure that the requirements may be effective on June 16, 1997. In addition, we will seek final OMB approval for these modifications.

443. The Further Notice of Proposed Rulemaking contains either a proposed or modified information collection. As part of its continuing effort to reduce paperwork burdens, we invite the general public and the OMB to take this opportunity to comment on the information collections contained in the Further Notice of Proposed Rulemaking, as required by the Paperwork Reduction Act of 1995, 44 U.S.C. §§ 3501-3520. Public and agency comments are due at the same time as other comments on the Further Notice of Proposed Rulemaking; OMB comments are due 60 days from date of publication of the Further Notice of Proposed Rulemaking in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of

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[640] *Notice of Office Management and Budget Action,* OMB No 3060-0760 (Apr. 1, 1997).

[641] *See* Section VI.D., *supra*.

the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

B. Initial Regulatory Flexibility Act Analysis

444. Pursuant to the Regulatory Flexibility Act (RFA),[642] the Commission has prepared the following initial regulatory flexibility analysis (IRFA) of the expected impact on small entities of the policies and rules proposed in the Further Notice of Proposed Rulemaking (Further Notice). Written public comments are requested on the IRFA. These comments must be filed in accordance with the same filing deadlines as comments on the rest of the Further Notice, but they must have a separate and distinct heading designating them as responses to the regulatory flexibility analysis. The Secretary shall cause a copy of the Further Notice, including the initial regulatory flexibility analysis, to be sent to the Chief Counsel for Advocacy of the Small Business Administration in accordance with Section 603(a) of the RFA.[643]

445. Reason for action. The Commission has revised its interstate access charge rules to make them consistent with the Telecommunications Act of 1996. As discussed in Section VII.A of the Further Notice, multi-line business customers will pay a higher subscriber line charge as a result of access charge reform, while special access customers do not pay such a charge. In addition, as the PICCs are phased in IXCs will be required to pay a substantially higher PICC for a multi-line business end user compared to the PICC paid for a primary residential end user or single-line business end user. An IXC serving multi-line business customers through special access can avoid paying the PICCs. As discussed in Section VII.B, the current allocation of general support facilities expenses enables incumbent LECs to recover through regulated interstate access charges costs caused by the LECs' nonregulated billing and collection functions.

446. Objectives. In Section VII.A, by proposing to allow LECs to impose a subscriber line charge on special access customers, we seek to prevent a decrease in projected revenue from multi-line subscriber line charges and PICCs caused by the migration of certain multi-line business customers from the public switched network to special access. In Section VII.B, we seek to revise the Commission's current allocation of price cap LECs' interstate

[642] 47 U.S.C. § 603. The RFA, *see* 5 U.S.C. § 601 *et seq.*, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-21, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the "Small Business Regulatory Enforcement Fairness Act of 1996" (SBREFA).

[643] 47 U.S.C. § 603(a).

costs between regulated interstate access services and nonregulated billing and collection activities to move interstate access rates closer to cost, consistent with the 1996 Act's new competitive paradigm.

447. Legal Basis. The proposed action is supported by Sections 4(i), 4(j), 201-205, 208, 251, 252, 253, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 201-205, 208, 251, 252, 253, 403.

448. Description, potential impact and number of small entities affected. For purposes of this Further Notice, the Regulatory Flexibility Act defines a "small business" to be the same as a "small business concern" under the Small Business Act (SBA), 15 U.S.C. § 632, unless the Commission has developed one or more definitions that are appropriate to its activities.[644] Under the SBA, a "small business concern" is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the SBA.[645] The Small Business Administration has defined a small business for Standard Industrial Classification (SIC) category 4813 (Telephone Communications, Except Radiotelephone) to be a small entity that has no more than 1500 employees.[646]

449. *Total Number of Telephone Companies Affected.* The proposals in Sections VII.A and VII.B of this Further Notice, if adopted, would affect all LECs that are regulated by the Commission's price cap rules. Currently, 13 incumbent LECs are subject to price cap regulation. We tentatively conclude that all price cap carriers have more than 1500 employees and, therefore, are not small entities.

450. Reporting, record keeping and other compliance requirements. It is not clear whether, on balance, all proposals in this Further Notice would increase or decrease incumbent LECs' administrative burdens.

451. We believe that the reforms proposed in Section VII.A of this Further Notice would require price cap LECs (not small entities) to make at least one tariff filing, and possibly several additional filings, but otherwise should not affect their administrative burdens. The reforms proposed in Section VII.B of the Further Notice may require price cap LECs (not small entities) to study the uses of the general purpose computer assets recorded in

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[644] *See* 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 15 U.S.C. § 632).

[645] 15 U.S.C. § 632. *See, e.g.,* Brown Transport Truckload, Inc., v. Southern Wipers, Inc., 176 B.R. 82 (N.D. Ga. 1994).

[646] 13 C.F.R. § 121.201.

Account 2124 to determine the percentage of investment in that account that is used for billing and collection activities, but otherwise should not affect their administrative burdens.

452. Federal rules which overlap, duplicate or conflict with this proposal. None.

453. Any significant alternatives minimizing impact on small entities and consistent with stated objectives. In Sections VII.A and VII.B of this Further Notice, we limit the scope of our proposals to incumbent price cap LECs, thereby not affecting small entities. We seek comment on these proposals and urge that parties support their comments with specific evidence and analysis.

C. Further Notice of Proposed Rulemaking Comment Filing Dates

454. Pursuant to applicable procedures set forth in Section 1.399 and 1.411 *et seq.* of the Commission's rules, 47 C.F.R. Sections 1.399, 1.411 *et seq.*, interested parties may file comments in response to the Further Notice of Proposed Rulemaking, including comments ont he information collection requirements, no later than June 26, 1997 with the Secretary, Federal Communications Commission, Washington D.C. 20554. Interested parties may file replies no later than July 11, 1997, except that reply comments on the information collection requirements are due no later than July 28, 1997. To file formally in this proceeding, participants must file an original and twelve copies of all comments, reply comments, and supporting comments. If participants want each Commissioner to receive a personal copy of their comments, an original plus 16 copies must be filed. In addition, parties should file two copies of any such pleading with the Competitive Pricing Division, Common Carrier Bureau, Room 518, 1919 M Street, N.W., Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room 239, 1919 M Street, N.W., Washington D.C. 20554.

455. Parties submitting diskettes should submit them along with their formal filings to the Office of the Secretary. Submissions should be on a 3.5 inch diskette formatted in an DOS PC compatible form. The document should be saved in WordPerfect 5.1 for Windows format. The diskette should be submitted in "read only" mode. The diskette should be clearly labelled with the party's name, proceeding, type of pleading (comment or reply comment), docket number, and date of submission.

456. You may also file informal comments electronically via e-mail <access@fcc.gov>. Only one copy of electronically-filed comments must be submitted. You must put the docket number of this proceeding in the subject line (see the caption at the beginning of this Notice, or in the body of the text if by Internet). You must note whether an electronic submission is an exact copy of formal comments on the subject line. You also must include your full name and Postal Service mailing address in your submission.

457. Comments and replies must comply with Section 1.49 and all other applicable sections of the Commission's rules. We also direct all interested parties to include the name of the filing party and the date of the filing on each page of their comments and replies. Comments and replies must also clearly identify the specific portion of this Notice of Proposed Rulemaking to which a particular comment or set of comments is responsive. If a portion of a party's comments does not fall under a particular topic listed in the Table of Contents of this Notice, such comments must be included in a clearly labelled section at the beginning or end of the filing.

458. Written comments by the public on the proposed and/or modified information collections are due July 28, 1997. Written comments must be submitted by the Office of Management and Budget (OMB) on the proposed and/or modified information collections on or before 60 days after date of publication in the Federal Register. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Judy Boley, Federal Communications Commission, Room 234, 1919 M Street, N.W., Washington, DC 20554, or via the Internet to jboley@fcc.gov and to Timothy Fain, OMB Desk Officer, 10236 NEOB, 725 - 17th Street, N.W., Washington, DC 20503 or via the Internet to fain_t@al.eop.gov.

X. ORDERING CLAUSES

459. Accordingly, IT IS ORDERED, pursuant to Sections 1-4, 10, 201-205, 251, 254, 303(r), and 410(a) of the Communications Act of 1934, as amended, and Section 601 of the Telecommunications Act of 1996, 47 U.S.C. §§ 151-154, 160, 201-205, 251, 254, 303(r), 410(a), and 601, that the ORDER IS ADOPTED.

460. IT IS FURTHER ORDERED that the provisions in this Order will be effective June 15, 1997. We anticipate this date will be at least thirty days after publication of this Order in the Federal Register. If publication of this Order is delayed, however, we find good cause under 5 U.S.C. § 553(d)(3) to make this Order effective less than thirty days after publication, because the local exchange carriers subject to price cap regulation must file tariffs by June 16, in order for them to be effective on July 1, 1997, as required by Section 69.3 of the Commission's rules, 47 C.F.R. § 69.3. In addition, to ensure that the local exchange carriers subject to price cap regulation have actual notice of this Order immediately following its release, we are serving those entities by certified first class mail. The collections of information contained within are contingent upon approval by the Office of Management and Budget.

461. IT IS FURTHER ORDERED that the following rules or amendments thereto, which impose new or modified information or collection requirements, shall become effective upon approval by the Office of Management and Budget (OMB), but no sooner than June 15,

1997: 47 CFR §§ 61.45, 61.47, 69.104, 69.126, 69.151, and 69.152. The following rules, or amendments thereto, shall be effective 30 days after publication in the Federal Register: 47 CFR §§ 69.103, 69.107, 69.122, 69.303, and 69.304. The following rules, or amendments thereto, in this Report and Order shall be effective January 1, 1998: 47 CFR §§ 61.3, 61.46, 69.1, 69.2, 69.105, 69.123, 69.124, 69.125, 69.154, 69.155, 69.157, 69.305, 69.306, 69.309, 69.401, 69.411, 69.502, and 69.611. The removal of the following sections is effective January 1, 1998: 47 CFR §§ 69.201, 69.203, 69.204, 69.205, and 69.209. The following rules, which impose new or modified information or collection requirements, shall become effective upon approval by the Office of Management and Budget (OMB), but no sooner than January 1, 1998: 47 CFR §§ 61.42, 61.48, 69.4, 69.106, 69.111, 69.153, 69.156. Unless otherwise stated herein, all remaining provisions of this Order are effective June 15, 1997."

462. IT IS FURTHER ORDERED that the waiver petitions of Bell Atlantic, Pacific Bell, GTE, Cincinnati Bell, U S West, and BellSouth discussed in Section III.A.5., regarding Section 69.104 as applied to ISDN service ARE DISMISSED.

463. IT IS FURTHER ORDERED that the rulemaking proceeding in CC Docket No. 95-72 IS TERMINATED.

464. IT IS FURTHER ORDERED, pursuant to Sections 1-4, 10, 201-205, 251, 254, 303(r), and 701 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154, 160, 201-205, 251, 254, 303(r), and 601, that NOTICE IS HEREBY GIVEN OF the rulemaking described above and that COMMENT IS SOUGHT on these issues.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

APPENDIX A

List of Commenters in CC Docket Nos. 96-262, 94-1, 91-213

ACC Long Distance Corp. (ACC Long Distance)
Ad Hoc Telecommunications Users Committee (Ad Hoc)
AirTouch Communications, Inc. (AirTouch)
Alabama Public Service Commission (Alabama Commission)
Alaska Telephone Association
Aliant Communications Co., formerly Lincoln Telephone (Aliant)
Allied Communications Group, Inc. (Allied)
Alliance for Public Technology
ALLTEL Telephone Services Corporation (ALLTEL)
American Association for Adult and Continuing Education, *et al.*
American Assocation for Retired Persons, *et al.* (AARP, *et al.*)
America On-Line, Inc. (America On-Line)
American Library Association
American Petroleum Institute (API)
America's Carriers Telecommunication Association (ACTA)
Ameritech
Association for Local Telecommunications Services (ALTS)
AT&T Corp. (AT&T)
Bankers Clearing House, *et al.*
Bell Atlantic Telephone Companies and NYNEX (BA/NYNEX)
BellSouth Corporation, BellSouth Telecommunications, Inc. (BellSouth)
Cable & Wireless, Inc. (Cable & Wireless)
[People of the State of] California and the Public Utility Commission of the State of California (California Commission)
California Cable Television Association
Cathey, Hutton and Associates
Centennial Cellular Corporation
Cincinnati Bell Telephone Company (Cincinnati Bell)
Citizens for a Sound Economy Foundation (CSE)
Citizens Utilities Company (Citizens Utilities)
Commercial Internet Exchange Association (CIEA)
Communications Workers of America (CWA)
Competition Policy Institute
Competitive Telecommunications Association (CompTel)
CompuServe, Inc. and Prodigy Services Corporation (CompuServe/Prodigy)
Consumer Project on Technology (Consumer Project)
[Public Service Commission of the] District of Columbia (District of Columbia Commission)
Evans Telephone Company, *et al.* (Evans, *et al.*)

Excel Telecommunications, Inc. (Excel)
Florida Public Service Commission (Florida Commission)
Frederick & Warinner, L.L.C. (Frederick & Warinner)
Frontier Corporation (Frontier)
General Communication, Inc. (GCI)
General Services Administration/United States Department of Defense (GSA/DOD)
Gallegos Family Network (Gallegos)
Gray Panthers
GVNW Inc./Management (GVNW)
GTE Service Corporation (GTE)
Harris, Skrivan & Associates, LLC (Harris, Skrivan & Associates)
ICG Telecom Group, Inc. (ICG)
Illinois Commerce Commission (Illinois Commission)
Illuminet
Independent Telephone & Telecommunications Alliance
Information Industry Association
Interactive Services Association
International Communications Association (Intl. Comm. Ass'n)
Internet Access Coalition
ITCs, Inc. (ITC)
IXC Long Distance, Inc.
Kansas Corporation Commission (Kansas Commission)
LCI International Telecom Corp. (LCI)
MCI Telecommunications Corporation (MCI)
Media Access Project, *et al.* (MAP, *et al.*)
Microsoft Corporation (Microsoft)
Minnesota Independent Coalition
Missouri Public Service Commission (Missouri Commission)
National Association of Regulatory Utility Commissioners (NARUC)
National Cable Television Association, Inc. (NCTA)
National Exchange Carrier Association, Inc. (NECA)
New York State Department of Public Service (New York Commission)
Newspaper Association of America
Northern Arkansas Telephone Company
[Commonwealth of] Northern Marianna Islands (Northern Marianna Islands)
[Public Utilities Commission of] Ohio (Ohio Commission)
Ohio Consumers' Counsel
[Public Utility Commission of] Oregon (Oregon Commission)
Ozarks Technical Community College
Pacific Telesis Group (PacTel)
Pennsylvania Internet Service Providers
Personal Communications Industry Association (PCIA)

Puerto Rico Telephone Company (Puerto Rico Tel.)
[Jon] Radoff (Radoff)
Roseville Telephone Company (Roseville Tel.)
Rural Telephone Coalition (Rural Tel. Coalition)
Rural Telephone Finance Cooperative
Rural Utilities Service
SDN Users Association Inc. (SDN Users Association)
Service-oriented Open Network Technologies, Inc. (SONETECH)
South Dakota Public Utilities Commission (South Dakota Commission)
Southern New England Telephone Company (SNET)
Southwestern Bell Telephone Company (SWBT)
Spectranet Interactive, Inc. (Spectranet)
Sprint Corporation (Sprint)
State Consumer Advocates
[John] Staurulakis, Inc. (Staurulakis)
TCA, Inc.-Telecommunications Consultants (TCA)
TDS Telecommunications Corporation (TDS)
Telco Communications Group, Inc. (Telco Communications Group)
Tele-Communications, Inc. (TCI)
Telecommunications Resellers Association (TRA)
Teleport Communications Group Inc. (Teleport)
Tennessee Regulatory Authority (Tennessee Commission)
[Public Utility Commission of] Texas (Texas Commission)
Texas Office of Public Utility Counsel (Texas Public Utility Counsel)
Time Warner Communications Holdings, Inc. (Time Warner)
United States Telephone Association (USTA)
U S West, Inc. (U S West)
Washington Independent Telephone Association (WITA)
Washington Utilities and Transportation Commission (Washington Commission)
Lyman C. Welch
Western Alliance
WinStar Communications, Inc. (WinStar)
WorldCom, Inc. (WorldCom)

List of Replies in CC Docket Nos. 96-262, 94-1, 91-213

ACC Long Distance Corp. (ACC Long Distance)
Ad Hoc Telecommunications Users Committee (Ad Hoc)
Alarm Industry Communications Committee
[State of] Alaska (Alaska Commission)
Aliant Communications Co., formerly Lincoln Telephone (Aliant)
Alliance for Public Technology
ALLTEL Telephone Services Corporation (ALLTEL)
American Association for Adult and Continuing Education, *et al.*
American Assocation for Retired Persons, *et al.* (AARP, *et al.*)
America On-Line, Inc. (America On-Line)
American Communications Services, Inc.
American Petroleum Institute (API)
Ameritech
Arch Communications Group, Inc. (Arch Communications)
Association for Local Telecommunications Services (ALTS)
AT&T Corp. (AT&T)
Bankers Clearing House, *et al.*
Bell Atlantic Telephone Companies and NYNEX (BA/NYNEX)
BellSouth Corporation, BellSouth Telecommunications, Inc. (BellSouth)
[People of the State of] California and the Public Utility Commission of the State of California (California Commission)
Colorado Library Education and Healthcare Telecommunications Coalition
Commercial Internet Exchange Association (CIEA)
Competitive Telecommunications Association (CompTel)
CompuServe, Inc. and Prodigy Services Corporation (CompuServe/Prodigy)
Consumer Project on Technology (Consumer Project)
Cox Communications, Inc. (Cox)
General Communication, Inc. (GCI)
General Services Administration/United States Department of Defense (GSA/DOD)
Georgia Public Service Commission (Georgia Commission)
Consumers' Utility Counsel Division, (Georgia) Governor's Office of Consumer Affairs (Georgia Consumers' Utility Counsel)
GVNW Inc./Management (GVNW)
GTE Service Corporation (GTE)
State of Hawaii (Hawaii Commission)
ICG Telecom Group, Inc. (ICG)
Internet Access Coalition
IXC Long Distance, Inc.
LCI International Telecom Corp. (LCI)
Maine Public Utilities Commission (Maine Commission)

MCI Telecommunications Corporation (MCI)
Media Access Project, *et al.* (MAP, *et al.*)
Minnesota Independent Coalition
Minnesota Internet Services Trade Association
National Cable Television Association, Inc. (NCTA)
National Exchange Carrier Association, Inc. (NECA)
[Public Utilities Commission of] Ohio (Ohio Commission)
Ohio Consumers' Counsel
Pacific Telesis Group (PacTel)
Personal Communications Industry Association (PCIA)
PSINet, Inc. (PSINet)
Puerto Rico Telephone Company (Puerto Rico Tel.)
Roseville Telephone Company (Roseville Tel.)
Rural Telephone Coalition (Rural Tel. Coalition)
Southern New England Telephone Company (SNET)
Southwestern Bell Telephone Company (SWBT)
Sprint Corporation (Sprint)
State Consumer Advocates
TDS Telecommunications Corporation (TDS)
Telco Communications Group, Inc. (Telco Communications Group)
Tele-Communications, Inc. (TCI)
Teleport Communications Group Inc. (Teleport)
Texas Association of Broadcasters
Texas Office of Public Utility Counsel (Texas Public Utility Counsel)
Time Warner Communications Holdings, Inc. (Time Warner)
United States Telephone Association (USTA)
U S West, Inc. (U S West)
WorldCom, Inc. (WorldCom)

APPENDIX B
COMMENT SUMMARY[1]

Table of Contents Paragraph

[1] Comments arranged with reference to sections of the Order.